No. 88-658

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

v.

STATE OF ILLINOIS, ex rel. NEIL F. HARTIGAN, Attorney General of the State of Illinois,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Of Counsel:

JOHN A. SIEGER
IRWIN A. BAIN
PANHANDLE EASTERN
PIPE LINE COMPANY
5400 Westheimer Court
Houston, Texas 77056
(713) 627-5400

PAUL H. LARUE *
JURIS KINS
GREGORY G. WROBEL
JAMES M. MROWICKI
ANDREW M. GARDNER
CHADWELL & KAYSER, LTD.
8500 Sears Tower
Chicago, Illinois 60606
(312) 876-2100

Attorneys for Petitioner
PANHANDLE EASTERN PIPE
LINE COMPANY

* Counsel of Record

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

QUESTIONS PRESENTED

1. Does the *en banc* decision below in effect overrule this Court's holding in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), barring indirect purchaser antitrust damage suits?

2. Are residential indirect purchasers of natural gas from petitioner, who do not purchase gas pursuant to preexisting, fixed quantity, cost-plus contracts with the direct purchaser, barred from seeking damages under Section 4 of the Clayton Act, 15 U.S.C. § 15 ("Section 4"), by *Illinois Brick*?

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioner Panhandle Eastern Pipe Line Company ("Panhandle")[1] respectfully requests that a writ of certiorari issue with respect to the judgment and *en banc* opinion of the United States Court of Appeals for the Seventh Circuit entered in this case on July 18, 1988.

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[1] Panhandle Eastern Pipe Line Company is a wholly owned subsidiary of Panhandle Eastern Corporation.

OPINIONS BELOW

The *en banc* opinion of the United States Court of Appeals for the Seventh Circuit is reported at 852 F.2d 891 (7th Cir. 1988) and is printed in the appendix at page A-1. The opinion of the three judge panel is reported at 839 F.2d 1206 (7th Cir. 1988) and is printed in the appendix at page B-1. The order of the Honorable Michael M. Mihm denying Panhandle's motion to dismiss is unreported and is printed in the appendix at page C-1.

JURISDICTION

The Seventh Circuit on September 4, 1985 granted petitioner's application for leave to take interlocutory appeal pursuant to 28 U.S.C. § 1292(b). The date of entry of the judgment of the Seventh Circuit was July 18, 1988. This petition was filed within ninety days thereafter and the jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTE INVOLVED

Section 4 of the Clayton Act, 15 U.S.C. § 15, provides in pertinent part:

> . . . [A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district

court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

STATEMENT OF THE CASE

Proceedings Below: Respondent, Neil Hartigan, Attorney General for the State of Illinois ("Attorney General"), brought *parens patriae* and class action claims for damages and injunctive relief under federal and state antitrust laws in February, 1984, in the United States District Court for the Central District of Illinois on behalf of indirect purchasers of gas from Panhandle in Illinois. The district court certified a class of over 300,000 indirect purchasers located in areas served exclusively by Panhandle.

The Attorney General alleges that Central Illinois Light Company ("CILCO"), a direct purchaser from Panhandle, was unable in 1983 to purchase certain gas from another supplier because Panhandle allegedly refused to transport this gas for CILCO; that, as a result, CILCO had to purchase higher priced gas from Panhandle; and that CILCO passed this so-called overcharge through to its customers (indirect purchasers). CILCO is the only one of Panhandle's 23 utility customers in Illinois specifically alleged to have made a request for transportation. Jurisdiction of the district court was based on Sections 4 and 16 of the Clayton Act, 15 U.S.C. §§ 15, 26. App. G-1.

Panhandle moved to dismiss all damage claims on behalf of indirect purchasers as barred by *Illinois Brick Co. v.*

Illinois, 431 U.S. 720 (1977). Although the district court acknowledged that the entire alleged overcharge was not passed on to CILCO's customers, it denied this motion, allowed the suit to proceed as to all indirect purchasers in the class and certified its order under 28 U.S.C. § 1292(b). App. C-7 - 8. The Seventh Circuit initially reversed the district court and barred all indirect purchaser damage claims. App. B-1. Dissenting in part, Judge Posner would have allowed the claims of "residential" indirect purchasers. On July 18, 1988, Judge Posner, in an opinion for a six-to-four majority of the court *en banc*, affirmed the district court as to claims of "residential" gas customers, but reversed as to claims of "industrial" customers and ordered their dismissal. App. A-14. The court's opinion expressly sanctions suits both by the direct purchaser and by "residential" indirect purchasers.

The result reached by the Seventh Circuit is novel and was not advocated by either party. The four dissenting judges would have reversed the district court and dismissed the claims of all indirect purchasers.

Panhandle's Operations: Panhandle owns and operates an interstate natural gas pipeline that brings gas from producing areas in the Gulf Coast and Mid-Continent areas of the United States to consuming regions in the Midwest. Panhandle is regulated by the Federal Energy Regulatory Commission ("FERC") under the Natural Gas Act, 15 U.S.C. §§ 717-717w, and the Natural Gas Policy Act, 15 U.S.C. §§ 3301 *et seq.* Panhandle purchases gas from producers, and sells most of this gas to local gas distribution companies ("LDC's"), such as CILCO, under approved tariffs and rate schedules. Increasingly, Panhandle also transports natural gas owned by others, including LDC's.

LDC Operations: CILCO and other LDC's resell most of the natural gas they purchase to end users for space

heating, water heating, cooking, air conditioning, irrigation, grain drying, electric generation, as a fuel for gas turbines, gas compressors, pumps, and other machinery, and as feedstock for the manufacture of synthetic materials and chemicals. LDC customers include both owners and renters of residential, commercial, industrial and agricultural property, such as hospitals and other institutions, factory operators, retailers, wholesalers, and farmers. Many LDC customers, of all types, have the actual or potential ability to use alternate fuels to perform the above functions. The Chairman of the Illinois Commerce Commission testified that even residential customers' demand for gas is elastic.

Customers of LDC's do not have contracts to purchase any fixed quantity of natural gas. Their gas purchases vary depending on a myriad of factors, including temperature, precipitation, the price of gas and alternate fuels, the cost of conservation measures, and the demand for their manufactured and agricultural products.

State Utility Regulation: CILCO and other investor-owned LDC's in Illinois are regulated by the Illinois Commerce Commission ("Ill.C.C."), which must approve their rates and tariffs.[2] LDC gas sales rates have three components: a fixed monthly demand charge; a uniform purchase gas adjustment charge covering the LDC's cost of gas; and a charge per unit of gas purchased covering, among other things, the LDC's allowed profit.

Since mid-1983, LDC's regulated by the Ill.C.C. have been required to comply with the Illinois Uniform Purchase Gas Adjustment ("PGA") with respect to the cost

[2] Of the 23 LDC's PEPL serves in Illinois, 17 are owned by municipal bodies and are not subject to the jurisdiction of the Ill.C.C.

of gas sold to their customers. Under the PGA mechanism, the price of gas to LDC customers is based on a monthly prediction of the weighted average cost of gas to the LDC. At the end of each year, actual and estimated gas costs are reconciled in a proceeding before the Ill.C.C. In 1983 and 1984, CILCO over-collected from its customers and it therefore made a refund after the yearly reconciliation through a reduction in the per unit price of gas purchased in the subsequent year. Customers who first received service after the reconciliation benefitted from this credit and therefore did not pay the full cost of gas during the refund period.

CILCO's Operations: Since the 1950's, CILCO has qualified as a "general service customer" under Panhandle's approved tariff. The tariff obligated Panhandle to provide all the gas CILCO required for its major service areas up to a stated contract demand. The principal condition for service under this tariff was that CILCO would not purchase natural gas for resale in those service areas from any "natural gas company" (as defined in 15 U.S.C. § 717a(6)) other than Panhandle. Under this tariff, Panhandle supplied virtually 100% of CILCO's gas requirements for those service areas. For its other service areas, CILCO purchased gas from other suppliers. Under the PGA, CILCO aggregated the cost of gas from all of its suppliers and applied the same purchased gas charge to all of its customers, irrespective of the source of gas actually supplied to the customer.

CILCO's sales to its customers in the early 1980's decreased (in one year, by as much as 14.7%) when the cost of Panhandle's gas to CILCO increased. From 1982 to 1984, CILCO lost 1754 customers of all types, including residential customers.

In 1983, CILCO responded to an increase in the cost of Panhandle's gas by adopting "Rate 7" for certain customers capable of switching to alternate fuels. Under Rate 7, CILCO was able to maintain essentially the same total price for gas service to Rate 7 customers by reducing its recovery of fixed costs and its profit. The effect of Rate 7 was to reduce CILCO's revenues by nearly $1 million. CILCO withdrew Rate 7 when Panhandle reduced the cost of its gas. Again, in 1986, CILCO absorbed gas costs by adopting Rider AP, which provided a lower rate to certain customers able to use alternate fuels.

CILCO's Suit: On March 16, 1987, CILCO, as the direct purchaser, filed an antitrust action in federal court against Panhandle alleging the same violations and seeking recovery of the same alleged overcharge as does the Attorney General in this action. App. F-11 - 12. CILCO claims damages in excess of $70 million with respect to sales made to residential, industrial and other customers, and also claims lost profits on sales not made.

REASONS FOR GRANTING THE WRIT

I. The Seventh Circuit's Decision Is In Direct Conflict With This Court's Controlling Decisions In *Hanover Shoe* And *Illinois Brick*

The Seventh Circuit's decision conflicts with and frustrates the general indirect purchaser bar by requiring, in each new case filed, an inquiry as to whether the reasons for the general bar exist in that specific case. It reinjects the complex issues and risk of duplicative recovery *Illinois Brick* sought to eliminate and defies this Court's settled construction of Section 4 of the Clayton Act that

the direct purchaser is the party "injured". It also impermissibly expands the narrow cost-plus exception. *Illinois Brick* bars all damage claims by indirect customers unless the "customer is committed to buying a fixed quantity regardless of price." 431 U.S. at 736. The decision here eliminates the fixed quantity requirement. As Senior Judge Fairchild aptly stated in his dissent below, "the Supreme Court did not leave it to the discretion of the lower courts to create new exceptions." App. A-19. The decision below incorrectly assumed such discretion and in effect created a new exception.

A. The Seventh Circuit's Decision Improperly Reexamines And Substantially Erodes The General Bar Of Indirect Purchaser Claims

Review is required because the Seventh Circuit's decision subverts *Illinois Brick*'s rationale and erodes its holding. In *Illinois Brick*, this Court established a general bar to indirect purchaser damage claims for allegedly illegal overcharges. The Court reaffirmed its holding in *Hanover Shoe Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), that, as a matter of law, the direct purchaser is the only person injured within the meaning of Section 4, and that it is injured by the full amount of the alleged overcharge. This Court found compelling policy reasons for a general bar: to provide the greatest incentive for direct purchasers to sue, to avoid complex damage tracing and apportionment problems, and to avoid the risk of duplicative recovery. *Illinois Brick*, 431 U.S. at 736-48. Even though the Court recognized that direct purchasers may not sue at all and may pass on the entire overcharge, it declined to sanction indirect purchaser suits in such cases. 431 U.S. at 746. The Court also recognized that damage tracing and apportionment problems, or the risk of duplicative recovery, would not be as serious in some

cases as in others, but again it declined to sanction indirect purchaser suits. 431 U.S. at 743-44.

The Seventh Circuit made a case-by-case determination as to whether the reasons this Court gave for its general bar of indirect purchaser suits are present here and found they are not. App. A-5 - 6. Its ruling thus confines *Illinois Brick* to its facts, contrary to this Court's express intent. 431 U.S. at 729. Because the general bar of indirect purchaser suits is based upon this Court's settled construction of Section 4, which Congress has not overruled despite repeated efforts during the past 11 years, the ruling also invades the province of this Court and Congress to reexamine the reasons for the bar. *See Illinois Brick*, 431 U.S. at 736-37; *Square D Co. v. Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409, 424 (1986).

The court below not only erred by requiring a case-by-case inquiry as to whether the reasons for the general bar are present, but also erred in concluding that they do not apply in this case.

Direct Purchaser's Incentive to Sue. The Seventh Circuit incorrectly assumes that direct purchasers subject to rate regulation, such as CILCO, lack sufficient incentive to sue. App. A-6 - 7. CILCO *has* sued Panhandle under the antitrust laws for the same alleged overcharge. Moreover, CILCO has vigorously challenged Panhandle in numerous FERC proceedings. It even filed a complaint before the FERC under Section 5 of the Natural Gas Act, 15 U.S.C. § 717d, challenging the same conduct at issue here. Likewise, other regulated gas utilities as direct purchasers have sought antitrust damages from interstate pipelines for allegedly illegal overcharges. *See In re Wyoming Tight Sands Antitrust Litigation*, 1988-2 Trade Cas. (CCH) ¶ 68,164 (D. Kan.), *appeal docketed*, Nos. 88-8042, 88-8043

(10th Cir. 1988). The Seventh Circuit's depiction of CILCO and other regulated gas utilities as "reluctant suitors" is not only contrary to fact,[3] but is also immaterial in light of this Court's refusal to allow indirect purchaser damage suits even where the direct purchaser has not sued. *Illinois Brick*, 431 U.S. at 746.

Damage Tracing and Apportionment Problems. The Seventh Circuit implicitly recognized that damage tracing and apportionment problems do exist here. App. A-13. Rather than dismissing all indirect purchaser claims, however, the court, in an apparent attempt to avoid these problems, made, *sua sponte*, a classification of "residential" and "industrial" customers, even though *Illinois Brick* forbids the classification of indirect purchasers. 431 U.S. at 744-45. This classification lacks a factual as well as a legal basis. The same PGA mechanism (*see supra*, pp. 5-6), which is the basis for the pass-through of gas costs, applies to all of CILCO's customers without distinction between "residential" and "industrial" customers.

Such customers, and those of other direct purchasers, do not fall into simple and discrete "residential" and "industrial" categories. *See supra*, pp. 4-5. CILCO, for example, sells gas for residential space heating under at least two different rate classifications, one of which also includes gas sales for commercial space heating and other

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[3] While the court's speculations are wholly irrelevant, there are many possible explanations for CILCO's delay in filing suit. CILCO may have delayed filing because the district court held that the indirect purchasers were the proper parties to sue. Moreover, CILCO had a clear economic interest in "free riding" on the Attorney General's efforts in this case. It is equally likely that CILCO considered the federal regulatory forum as the proper one in which to resolve the tariff issues on which the claims here are based.

uses. *See* CILCO's Tariffs, R. 105 at 129, R. 197. Indirect purchasers of all types have the ability either to use alternate fuels or to reduce substantially their purchases of gas in response to higher prices. Some "industrial" customers, however, may not have this ability.

The Seventh Circuit concluded, erroneously, that the damage tracing and apportionment problems which exist here should not bar the claims of residential customers by making unwarranted assumptions concerning the operation of public utility regulation of the direct purchaser. But the PGA mechanism does not guarantee a total pass-through of gas costs, as the Seventh Circuit itself recognized, because the direct purchaser can absorb a portion of an alleged overcharge in gas costs through a rate change or due to a sales decline causing it to under-recover its approved operating costs and profit. App. A-8, A-13 - 14.

Risk of Duplicative Recovery. The risk of multiple recovery clearly is present because CILCO already has sued Panhandle for the same overcharge plaintiff seeks.[4]

B. The Seventh Circuit's Decision Expands The Cost-Plus Exception By Eliminating The Preexisting Fixed Quantity Contract Requirement

Review is also required because the Seventh Circuit has discarded the preexisting fixed quantity contract require-

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[4] Although CILCO's case presently is pending before the same district judge as this case, CILCO has filed a jury demand. This may necessitate transfer of the case prior to trial because potential jurors are customers of CILCO and members of the class in this case. Thus, the current district judge may not be able to preside over the CILCO trial and thereby prevent duplicative recovery.

ment from the narrow cost-plus exception,[5] described in *Illinois Brick* as follows:

> But this Court in *Hanover Shoe* indicated the *narrow scope* it intended for any exception to its rule barring pass-on defenses by citing, as the only example of a situation where the defense *might* be permitted, a preexisting cost-plus contract. In such a situation, the purchaser is insulated from any decrease in its sales as a result of attempting to pass-on the overcharge, because its customer is committed to buying a fixed quantity regardless of price. The effect of the overcharge is essentially determined in advance, without reference to the interaction of supply and demand that complicates the determination in the general case.

431 U.S. at 735-36 (emphasis supplied). This Court refused to expand the exception or to create a new one, and stated that it would "adhere to the narrow scope of exemption indicated by" the *Hanover Shoe* decision. 431 U.S. at 745.

This Court described a simple and narrow exception capable of application at the outset of litigation on the basis of existing contractual terms. This exception operates to permit only a single suit and to eliminate uncertainty as to who may file it. The fixed quantity requirement insures that the direct purchaser can suffer no loss in sales and the cost-plus element insures that the direct purchaser passes on the entire overcharge. Thus, the

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[5] The author of the *en banc* decision, in his dissent from the original panel decision, described this Court's discussion of exceptions in *Hanover Shoe* and *Illinois Brick* as *dicta*. App. B-9. Since the present case involves what appears to be the first affirmative appellate application of the "cost-plus" exception on record evidence, the decision here merits review to reaffirm the narrow scope of the exception in a clear holding.

direct purchaser can suffer no injury under Section 4 and it therefore is barred under *Hanover Shoe* from seeking damages. Only then can the indirect purchaser sue.

The express requirements for this narrow exception are not satisfied here. The indirect purchasers do not have preexisting, fixed quantity commitments and, admittedly, the direct purchaser has lost sales. App. A-9.

The Seventh Circuit nevertheless attempts to construct a substitute for the fixed quantity requirement by theorizing that state utility regulation and the resulting "unused monopoly power" of the direct purchaser as to residential customers are an acceptable "stand-in." App. A-8. Its reformulated exception presumes that state regulation has forced the "utility to operate in a region of its demand curve where 100% passing on of any cost increase [is] the optimal strategy for the utility to follow." App. A-12.

This hypothesis is neither alleged nor is it supported by the record. Moreover, to establish this hypothesis requires consideration of the complex issues *Illinois Brick* sought to eliminate. Furthermore, even if true, the court's presumption—that the indirect purchasers' demand is inelastic—could only explain why the direct purchaser *might attempt* to pass on the cost increase entirely. Only perfectly inelastic demand, guaranteed through a fixed quantity provision, could insulate the direct purchaser from any decrease in sales, thus insuring that it will not choose to absorb part of the alleged overcharge. *See, e.g.*, Comment, *A Legal and Economic Analysis of the Cost-Plus Contract Exception in* Hanover Shoe *and* Illinois Brick, 47 U. Chi. L. Rev. 743, 763, 765 (1980) (cited by the Seventh Circuit, App. A-5).

The court admits that perfect inelasticity of demand is not present here, App. A-9 (*compare* A-9 *with* B-13), as

indeed it had to because CILCO did lose sales and did absorb part of the alleged overcharge. The Seventh Circuit's solution, allowing both the direct and indirect purchasers to sue, diminishes the direct purchaser's incentive to sue, and creates a risk of duplicative recovery not possible under the narrow exception described in *Illinois Brick*. Moreover, the court's rationale relies upon precisely the simplifying economic assumptions and unsupported economic inferences about demand elasticity rejected in *Illinois Brick*.[6] 431 U.S. at 741-42. As a result, the Seventh Circuit excepts simple cost-plus pricing (i.e. a pricing mechanism lacking a preexisting relationship and a fixed quantity requirement) from the general indirect purchaser bar, which this Court expressly declined to do in *Illinois Brick*. 431 U.S. at 744.

II. The Seventh Circuit's Opinion Adds To A Conflict Among The Circuits On The Limited Circumstances That Permit Suits By Indirect Purchasers For Recovery Of An Illegal Overcharge

The Seventh Circuit frankly concedes that its decision is in conflict with other circuits. App. A-3 - 5. Conflicts exist as to whether: 1) a fixed quantity provision is a requirement of a "cost-plus" exception; 2) the express requirements of the exception can be satisfied by some functional equivalent; and 3) the arrangement must be preexisting to guarantee in advance a complete pass-through.

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[6] While explicit references to demand elasticity in Judge Posner's dissent to the panel's opinion were omitted from his opinion for the court *en banc*, the analysis in both opinions employs this concept.

A. The Circuits Are Split Over The Fixed Quantity Requirement

The Seventh Circuit acknowledged that the Third, Eighth and Ninth Circuits have held that the cost-plus exception requires a fixed quantity provision. App. A-3. *See Midwest Paper Products Co. v. Continental Group, Inc.*, 596 F.2d 573, 577 n.9, 580 (3d Cir. 1979); *In re Mid-West Milk Monopolization Litigation*, 730 F.2d 528, 533 (8th Cir.), *cert. denied*, 469 U.S. 924 (1984); *Arizona v. Shamrock*, 729 F.2d 1208, 1212 n.2 (9th Cir. 1984), *cert. denied*, 469 U.S. 1197 (1985).[7] The Second and Fourth Circuits also require a fixed quantity provision for the assertion of a pass-on defense. *United States v. Consolidated Edison Co.*, 580 F.2d 1122, 1132 n.21 (2d Cir. 1978) (considering *Hanover Shoe* in a breach of contract action); *Phillips v. Crown Center Petroleum Corp.*, 602 F.2d 616 (4th Cir. 1979), *cert. denied*, 444 U.S. 1074 (1980). Under these rulings only one claim for damages is allowed—either by the direct or indirect purchaser.[8]

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[7] The Third Circuit also has recognized the importance of the fixed quantity requirement in rejecting a pass-on defense under *Hanover Shoe* because the direct purchaser was not insulated from a loss of sales. *See* Abbott Dairies v. Butz, 584 F.2d 12 (3d Cir. 1978). *Cf.* Merican, Inc. v. Caterpillar Tractor, Co., 713 F.2d 958 (3d Cir. 1983), *cert. denied*, 465 U.S. 1024 (1984) (Indirect purchaser suit dismissed because direct purchaser may have been injured by the alleged overcharge).

[8] Numerous district court decisions also have required fixed quantity provisions. *See, e.g.*, Lefrak v. Arabian American Oil Co., 487 F. Supp. 808, 819 (E.D.N.Y. 1980); *In re* Wyoming Tight Sands Antitrust Cases, 1988-2 Trade Cas. (CCH) ¶ 68,164 (D. Kan. 1988), *appeal docketed*, Nos. 88-8042, 88-8043 (10th Cir. 1988); International Ass'n of Machinists v. OPEC, 447 F. Supp. 553, 562 (C.D. Cal. 1979), *aff'd on other grounds*, 649 F.2d 1354 (9th Cir. 1981), *cert. denied*, 454 U.S. 1163 (1982).

The only circuits which have not required a fixed quantity provision, in conflict with the above decisions (and *Illinois Brick*), are the Seventh in this case and the Fifth in *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148, 1164 (5th Cir. 1979), *cert. denied*, 449 U.S. 905 (1980).

B. The Circuits Are Divided As To The Propriety Of The Functional Equivalent Approach

The circuits also are divided over whether any of the components of the "preexisting, fixed quantity, cost-plus contract" exception can be satisfied by their "functional equivalent," such as economic conditions and pricing mechanisms which allegedly insure a total pass-through of an alleged overcharge.

The Fifth Circuit has adopted the "functional equivalent" test, the most liberal standard allowing indirect purchasers to sue. *In re Beef, supra.* It held that plaintiffs need not prove a preexisting, cost-plus contract, but can satisfy the exception by proving—based on the inelasticity of the supply market and the use of a rigid, industry-wide pricing formula—that the impact of price changes can be determined in advance.

The Third Circuit, in accordance with *Illinois Brick*, refused to expand the exception to include such simple cost-plus arrangements and thereby rejected the functional equivalent approach. *Midwest Paper*, 596 F.2d at 577 n.9, 580. The Second and Fourth Circuits are in accord with this position, having rejected pass-on defenses where there were no preexisting, fixed quantity, cost-plus contracts. *United States v. Consolidated Edison Co., supra*; *Phillips v. Crown Center Petroleum Corp., supra*; *see also New York v. Hendrickson Bros., Inc.*, 840 F.2d 1065, 1078-80 (2d Cir. 1988), *petition for cert. filed*, 57 U.S.L.W. 3061 (U.S. July 26, 1988) (No. 88-21) (no pass-on defense because no proof of "a contract showing that the effect of their

[defendants'] overcharges was 'essentially determined in advance' ").

The Seventh Circuit eschews the "functional equivalent" test of *In re Beef* because that test employs an analysis this Court "disparaged in *Illinois Brick*" and because the test was "effectively criticized" in *In re Mid-West Milk Monopolization Litigation*, 529 F. Supp. 1326, 1337-38 (W.D. Mo. 1982), *aff'd*, 730 F.2d 528 (8th Cir.), *cert. denied*, 469 U.S. 924 (1984). App. A-5. Thus, the instant decision conflicts with the Fifth Circuit, which adopted the functional equivalent test, as well as with the Third Circuit, which applied *Illinois Brick* literally.[9]

Unless this Court reaffirms the narrow scope of the cost-plus exception announced in *Illinois Brick*, courts applying the functional equivalent test will continue to engage in the complicated factual inquiry it requires.[10]

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[9] Despite its disclaimer, one could nevertheless conclude that the Seventh Circuit in fact may have used the functional equivalent test because it relied on economic assumptions as a substitute for a pre-existing, fixed quantity, cost-plus contract. App. A-6 - 8, 13-14. Even if true, its decision would still conflict with the Third Circuit. Moreover, the functional equivalent test cannot be satisfied here because regulation of the direct purchaser does not guarantee in advance a complete pass-through of the alleged overcharge and does not insulate the direct purchaser from injury due to lost sales. *See supra*, pp. 10-11.

[10] Other circuits have discussed the "functional equivalent" test, but found the indirect purchaser claims or the pass-on defenses did not satisfy even this test and therefore did not have to accept or reject it. *See* Jewish Hospital Ass'n v. Stewart Mechanical Enterprice, Inc., 628 F.2d 971 (6th Cir. 1980), *cert. denied*, 450 U.S. 966 (1981); In re Mid-West Milk Monopolization Litigation, 730 F.2d 528, 533 (8th Cir.), *cert. denied*, 469 U.S. 924 (1984) (also finding no preexisting, fixed quantity, cost-plus contract); Zinser v. Continental Grain Co., 660 F.2d 754 (10th Cir. 1981), *cert. denied*, 455 U.S. 941 (1982); Eastern Air Lines Inc. v. Atlantic Richfield, 609 F.2d 497 (Temp. Emer. Ct. App. 1979); Gulf Oil Corp. v. Dyke, 734 F.2d 797 (Temp. Emer. Ct. App. 1984), *cert. denied*, 469 U.S. 852 (1985).

C. The Seventh Circuit's Decision Conflicts With A Ruling Of The Sixth Circuit Regarding The "Pre-existence" Requirement

The Seventh Circuit engaged in a *post hoc* examination of rates and sales to determine whether, as to residential customers, the overcharge was passed through. This *post hoc* examination conflicts with *Illinois Brick* and the Sixth Circuit's holding in *Jewish Hospital Ass'n. v. Stewart Mechanical Enterprises, Inc.*, 628 F.2d 971 (6th Cir. 1980), *cert. denied*, 450 U.S. 966 (1981), that there must be a preexisting relationship that insures in advance that the whole overcharge will be passed through. The Sixth Circuit's approach has also been employed by the Temporary Emergency Court of Appeals to bar a pass-on defense even where the trier of fact had determined the amount of the overcharge passed on. *Gulf Oil Corp. v. Dyke*, 734 F.2d 797 (Temp. Emer. Ct. App. 1984), *cert. denied*, 469 U.S. 852 (1985); *see also Eastern Air Lines Inc. v. Atlantic Richfield Co.*, 609 F.2d 497 (Temp. Emer. Ct. App. 1979).

The arrangement here lacks the preexistence factor that guarantees in advance a complete pass-through. Indirect purchasers, including "residentials", not only may vary the quantity of gas they purchase, but also may switch to alternate fuels. Also, direct purchasers can, as did CILCO, lower their profit margins in response to gas price increases and resulting declining sales so as to lower the total price paid by indirect purchasers.

D. The Conflict Is Clear From The *En Banc* Decision Itself

As recognized by the four dissenters, the indirect purchaser claims of both the residential and industrial customers should be barred because the purchases are not pursuant to a fixed quantity contract as is required under

Midwest Paper and *Illinois Brick*. App. A-18. This circumstance creates a conflict, readily conceded by the Seventh Circuit, between its decision and those of other circuits. App. A-3.

III. To Preserve the *Illinois Brick* Rule and To Ensure Efficient Administration of Justice, the Seventh Circuit's Decision Allowing Indirect Purchaser Suits Should Be Reviewed and Reversed

If the instant decision is not reviewed and reversed, the objectives of the *Illinois Brick* and *Hanover Shoe* decisions will be undermined, if not completely frustrated.[11] The Seventh Circuit has authorized antitrust damage claims by both direct and indirect purchasers based on the same alleged overcharge. This diminishes the incentive of direct purchasers to sue, raises complex issues of apportionment and tracing of damages, creates risks of duplicative recovery, and will consume enormous amounts of judicial resources both in this case and in other cases.

The Seventh Circuit's decision barring some, but not all, indirect purchaser claims here creates an unworkable rule which will require the district court to address a number of complex issues that *Illinois Brick* intended to avoid. It lacks a workable standard for distinguishing the industrial, residential, commercial, agricultural, and many

[11] Review of this interlocutory appeal is timely. The district court conducted a trial on liability while this appeal was pending. It has not yet ruled on the merits, but it did reconsider and reaffirm its earlier ruling on *Illinois Brick* based upon the trial record. App. D-2. If liability were found, a trial on damages still would be necessary in which the complex issues discussed in this section will be confronted. Even if liability were not found, those issues may arise in CILCO's action against PEPL. Moreover, absent a subsequent appeal, the instant decision will remain the law, certainly in the Seventh Circuit.

other types of indirect purchasers. It fails to resolve expressly the claims of many customers who are not clearly "industrial" or "residential." *See supra*, pp. 4-5. It fails to establish what degree of demand elasticity entitles various indirect purchasers to sue, and how this must be alleged and proven within the meaning of Section 4. It requires a complicated analysis of purchasing practices and competitive alternatives of various types of indirect purchasers. It lacks general guidelines for application to the circumstances of the many other direct purchasers in this case, as well as in other cases where the direct purchaser is subject to any form of "regulatory cost-plus pricing." This decision reinjects the complex issues, the detailed factual analysis, and the case-by-case determination that *Illinois Brick* and *Hanover Shoe* sought to preclude.

The Seventh Circuit's decision introduces complex apportionment problems within its *ad hoc* "residential" category of indirect purchasers. It allows individual residential indirect purchasers to maintain actions for the amount of the alleged overcharge each paid. The delay in passing on the alleged overcharge resulting from the PGA reconciliation proceeding (*see supra*, p. 6) complicates the determination of the amount of the overcharge borne by an individual residential indirect purchaser. Moreover, the direct purchaser's cost of gas is determined by rolling in the price of gas from all sources, and this cost (which includes the alleged overcharge) is then spread equally among all the direct purchaser's customers, including those who are not members of the class. Thus, the Seventh Circuit's ruling creates apportionment problems because persons not members of the class will have borne part of the overcharge.

The decision here, by permitting both direct and indirect purchaser suits, may also inject similar complex issues in virtually all direct purchaser suits, since defendants in

such suits will be compelled to assert a *Hanover Shoe* defense to avoid the risk of duplicative recovery.

The potential for mischief of the Seventh Circuit's decision is clear—it is certain to interfere with antitrust damage claims by price-regulated plaintiffs, such as taxicab companies, other local and interstate carriers, banks and other financial institutions whose rates are regulated, insurance companies, and of course, local gas, electric, water, and telephone utilities. Moreover, the court's ruling undoubtedly will be raised in pass-through cases involving unregulated direct purchasers. Furthermore, the court's ruling cannot be applied on the basis of the complaint and answer (or even a few simple affidavits), but requires instead extensive evaluation of the cost pass-through characteristics of the plaintiff's pricing practices and of its market. The court below has substituted an enormously complex test for a simple rule in the determination of who is the proper party to sue. As a result, the most efficient enforcer of the antitrust laws—the direct purchaser—will be deterred from suing due to the possibility of reduced damages and the cost of litigating a pass-on defense. *See* Landes & Posner, *Should Indirect Purchasers Have Standing to Sue Under the Antitrust Laws? Economic Analysis of the Rule of* Illinois Brick, 46 U. Chi. L. Rev. 602, 608-9 (1979) ("[T]he direct purchaser is a more efficient enforcer of the antitrust laws than the indirect purchaser and should therefore be given maximum incentive to bring antitrust suits").

In fact, the decision here creates a preferred status for indirect purchaser suits in regulated industries and also may prompt lower courts to employ similar economic assumptions to permit indirect purchaser suits in other market contexts. This will encourage the filing of class actions and *parens patriae* suits, often by Attorneys General. *Cf.* J. Cudahy concurring opinion, App. A-16. This Court opted

to have the antitrust laws enforced by direct purchasers in pass-on situations. Moreover, the Court recognized that class suits often afford little or no benefit to their members. *Illinois Brick*, 431 U.S. at 746-47. It has been noted that Attorneys General may bring class suits for reasons other than their intrinsic antitrust merits. *See* Landes & Posner, *supra*, at 612-13. Here, in the face of widely different federal regulatory policy, the Chairman of the Ill. C.C. used an Attorney's General class suit to further his own regulatory objectives for the interstate natural gas pipeline industry.

The decision undermines the fair and uniform application of the antitrust laws and engenders uncertainty for companies subject to suit in many circuits. Panhandle, for example, transacts business in the Fifth, Sixth, Eighth and Tenth Circuits, as well as the Seventh Circuit. The Tenth Circuit has a pending appeal of a decision dismissing claims brought by Attorneys General on behalf of indirect purchasers of natural gas from a different interstate pipeline. *In re Wyoming Tight Sands Antitrust Litigation, supra.* The risk to Panhandle of disparate treatment therefore is real.

Resolution of the clear conflict between this decision and *Illinois Brick*, as well as the decisions of other circuits, is necessary to promote the objectives of *Illinois Brick* and *Hanover Shoe* and the uniform application of the antitrust laws.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this Court should grant the Petition for Writ of Certiorari to review the *en banc* decision of the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

Of Counsel:

JOHN A. SIEGER
IRWIN A. BAIN
PANHANDLE EASTERN
PIPE LINE COMPANY
5400 Westheimer Court
Houston, Texas 77056
(713) 627-5400

PAUL H. LARUE *
JURIS KINS
GREGORY G. WROBEL
JAMES M. MROWICKI
ANDREW M. GARDNER
CHADWELL & KAYSER, LTD.
8500 Sears Tower
Chicago, Illinois 60606
(312) 876-2100

Attorneys for Petitioner
PANHANDLE EASTERN PIPE
LINE COMPANY

* Counsel of Record

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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

v.

STATE OF ILLINOIS, ex rel. NEIL F. HARTIGAN, Attorney General of the State of Illinois,

Respondent.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Of Counsel:

JOHN A. SIEGER
IRWIN A. BAIN
PANHANDLE EASTERN
PIPE LINE COMPANY
5400 Westheimer Court
Houston, Texas 77056
(713) 627-5400

PAUL H. LARUE *
JURIS KINS
GREGORY G. WROBEL
JAMES M. MROWICKI
ANDREW M. GARDNER
CHADWELL & KAYSER, LTD.
8500 Sears Tower
Chicago, Illinois 60606
(312) 876-2100

Attorneys for Petitioner
PANHANDLE EASTERN PIPE
LINE COMPANY

* Counsel of Record

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

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APPENDIX A

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 85-2601

STATE OF ILLINOIS EX REL. NEIL F. HARTIGAN, Attorney General of the State of Illinois, in its proprietary capacity, in its *parens patriae* capacity, and in its representative capacity,

Plaintiff-Appellee,

v.

PANHANDLE EASTERN PIPE LINE COMPANY,

Defendant-Appellant.

Appeal from the United States District Court
for the Central District of Illinois, Peoria Division.
No. 84-1048—**Michael M. Mihm**, *Judge.*

ARGUED FEBRUARY 26, 1986—DECIDED JANUARY 22, 1988
REHEARING EN BANC MAY 26, 1988—DECIDED JULY 18, 1988

Before BAUER, *Chief Judge*, CUMMINGS, CUDAHY, POSNER, COFFEY, FLAUM, RIPPLE, MANION, and KANNE, *Circuit Judges*, and FAIRCHILD, *Senior Circuit Judge.**

POSNER, *Circuit Judge.* Central Illinois Light Company (CILCO) is a publicly regulated retail distributor of nat-

* Circuit Judges WOOD, JR. and EASTERBROOK did not participate in the consideration or decision of this case.

ural gas. It bought natural gas from Panhandle Eastern Pipe Line Company at prices allegedly inflated because of violations of the antitrust laws by Panhandle, and resold the gas to residential and industrial consumers. In its resales to residential consumers, CILCO passed on the entire overcharge in the form of higher rates. In 1984 the State of Illinois brought this federal antitrust suit on behalf of CILCO's customers against Panhandle—which moved to dismiss the suit as barred by the "indirect purchasers" rule of *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), and *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977). The district court denied the motion, but certified its order of dismissal for an immediate appeal under 28 U.S.C. § 1292(b), and we agreed to hear the appeal. A panel of this court reversed the district court and directed it to dismiss the complaint. 839 F.2d 1206 (7th Cir. 1988). The full court granted rehearing en banc to decide whether regulatory cost-plus pricing can ever be excepted from the rule that "indirect purchasers" (CILCO's customers are indirect purchasers from Panhandle, CILCO being the direct purchaser) are barred from obtaining antitrust damages from their indirect seller. While the appeal was pending in this court, the district judge conducted a 13-week trial on liability, but he has deferred making a decision until we decide the appeal.

In *Hanover Shoe* the Supreme Court held that it is not a defense to an antitrust damages action that a buyer forced to pay a higher price because of the seller's antitrust violation passed on the cost of the violation to the buyer's customers (the seller's indirect purchases) by raising his prices to them, unless the buyer had a cost-plus contract with these customers. *Illinois Brick* announced a corollary to *Hanover Shoe*: the indirect purchaser cannot sue to recover the part of the overcharge that the buyer passed on to him. The Court again recognized an exception for the cost-plus contract, noting that it insulates the direct purchaser from "any decrease in its sales as a result of attempting to pass on the overcharge, because

its customer is committed to buying a fixed quantity regardless of price." *Id.* at 736. Fastening on the words "fixed quantity," the panel majority in this case held that the cost-plus exception is never available when the indirect purchasers are free to vary the quantity they buy from the direct purchaser. The question for decision today is whether the exception is as confined as the panel thought.

The panel's opinion was not the first to read the exception so narrowly. See *Mid-West Paper Products Co. v. Continental Group, Inc.*, 596 F.2d 573, 577 n. 9, 580 (3d Cir. 1979); *In re Midwest Milk Monopolization Litigation*, 730 F.2d 528, 533 (8th Cir. 1984); *Lefrak v. Arabian American Oil Co.*, 487 F. Supp. 808, 819 (E.D.N.Y. 1980); cf. *Arizona v. Shamrock Foods Co.*, 729 F.2d 1208, 1212 n. 2 (9th Cir. 1984); but see *In re Uranium Antitrust Litigation*, 552 F. Supp. 518 (N.D. Ill. 1982). And its reading was followed in *In re Wyoming Tight Sands Antitrust Cases*, No. 85-2349-S (D. Kan. May 4, 1988). Yet it was not dictated by precedent. Not only had the prior cases all involved privately negotiated cost-plus contracts rather than cost-plus contractual provisions required by public utility regulation, but there was no reason to believe that the reference to "fixed quantity" in the Supreme Court's opinion in *Illinois Brick* was intended to govern cases so remote from the actual arrangements under scrutiny in that case. The case did not involve a fixed-quantity contract; indeed, it did not involve a cost-plus contract, but merely an argument (which the Court rejected, see 431 U.S. at 744) that a buyer's practice of rule-of-thumb cost-plus pricing should be enough to allow his customers to sue the seller. Certainly there is no indication that by using the words "fixed quantity" the Supreme Court meant to address the issue of the status of regulatory cost-plus pricing. We do a disservice to the Court by wrenching its words out of context and giving them a talismanic significance; we make language a trap rather than a mode of communication. The Supreme Court has never adverted to the issue involved in the present case, and we must

consider that issue in relation to the rationale of *Illinois Brick* rather than to isolated phrases in the Court's opinion. If we are to play the language game to which Panhandle invites us, moreover, then we must consider isolated phrases in other Supreme Court opinions, notably the majority opinion in *Blue Shield of Virginia v. McCready*, 457 U.S. 465, 474-75 (1982), where the concern behind *Hanover Shoe* and *Illinois Brick* is described as "the risk of duplicative recovery engendered by allowing every person along a chain of distribution to claim damages arising from a single transaction that violated the antitrust laws." There is, as we shall see, no such risk in this case, at least so far as the residential purchasers from CILCO are concerned; and it is only they who have, in our view, a persuasive claim to be entitled to sue.

Although several district courts have rejected an exception for cost-plus rate regulation, see (besides *Tight Sands*) *Go-Tane Service Stations, Inc. v. Ashland Oil, Inc.*, 508 F. Supp. 200, 204 (N.D. Ill. 1981); *City of Cleveland v. Cleveland Electric, Illuminating Co.*, 538 F. Supp. 1320, 1323-27 (N.D. Ohio 1980); *U.S. Oil Co. v. Koch Refining Co.*, 518 F. Supp. 957, 962-63 (E.D. Wis. 1981), the cases are distinguishable; and in the case with facts most like those of the present case the court held that indirect purchasers could sue because public utility regulation had created "a straight cost passthrough." *In re New Mexico Natural Gas Antitrust Litigation*, 1982-1 Trade Cases ¶ 64,685, at p. 73,722 (D.N. Mex. 1982). Cf. *County of Oakland v. City of Detroit*, 628 F. Supp. 610, 613 (E.D. Mich. 1986); *Illinois v. Borg, Inc.*, 548 F. Supp. 972, 975-76 (N.D. Ill. 1982). An additional wrinkle in the *New Mexico Natural Gas* case, however, was that the direct purchasers were in cahoots with the defendants; this was an independent ground for allowing the indirect purchasers to sue.

It is possible to allow indirect purchasers to sue in a case such as the present one without embracing the ill-defined "functional equivalent" approach of *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148 (5th Cir. 1979);

see also, e.g., *Gulf Oil Corp. v. Dyke*, 734 F.2d 797, 809 (T.E.C.A. 1984). That approach—effectively criticized in *In re Midwest Milk Monopolization Litigation*, 529 F. Supp. 1326, 1337-38 (W.D. Mo. 1982), aff'd, 730 F.2d 528 (8th Cir. 1984); Comment, *A Legal and Economic Analysis of the Cost-Plus Contract Exception in Hanover Shoe and Illinois Brick*, 47 U. Chi. L. Rev. 743, 756-70 (1980), cf. *Abbott Dairies Division v. Butz*, 584 F.2d 12, 16-17 (3d Cir. 1978), and found to be inapplicable to conditions in the beef industry itself in *In re Beef Industry Antitrust Litigation*, 710 F.2d 216, 219-20 (5th Cir. 1983)—requires elaborate analysis of the incidence of a cost increase, which is precisely the analysis that the Court disparaged in *Illinois Brick*. Our approach does not require this. We have formal cost-plus pricing in this case rather than its "functional equivalent." We have formal cost-plus pricing, and more: a contract that required 100 percent passing on, and an acknowledgment of 100 percent passing on in every kilowatt hour resold to CILCO's residential consumers.

To determine whether (or to what extent) this case is within the rule of *Illinois Brick*, we must consider the reasons for confining the right to sue to the direct purchaser; for it is the reasons behind a rule that determine its scope. First, because the direct purchaser is closer to the violation and hence more likely to discover it, we want to make sure that he has a strong incentive to bring the violator to book, and we do this by holding out to him the prospect of recovering the entire damages caused by the violation if he wins the suit. Second, it is difficult to apportion damages between direct and indirect purchasers by the methods of litigation. A direct purchaser who finds himself paying a higher price for inputs would love to pass on all of the additional cost to his customers in the form of a higher price, but he cannot do so, because a price that much higher will so reduce the demand for his product that his profits will fall unacceptably. (If the higher price were optimal, the firm would have raised its price without waiting for its costs to increase.) The optimal adjustment by an unregulated firm to the increased cost of

the input will always be a price increase smaller than the increase in input cost, and this means that the increased cost will be divided between the two tiers, the direct and indirect purchasers—but in what proportions will often be hard to determine, even by sophisticated techniques of economic analysis. This is a central insight of the *Illinois Brick* decision. An additional complication that further demonstrates the wisdom of the decision is that the higher input price may induce the direct purchaser to use more of an alternative input, and this substitution will affect the proportion of the initial overcharge that the direct purchaser can recoup.

Where the direct purchaser has a cost-plus contract with his customers that requires them to buy a fixed quantity, the reasons for confining the right to seek damages to the direct purchaser cease to be fully persuasive. There is no longer a problem of apportionment, because the whole of any price increase will have been passed on to the customers by virtue of the contract. Yet the second reason for confining the right to seek damages to the direct purchaser survives: he has better information about the violation. And despite the cost-plus nature of the contract, he has everything to gain from suing. He will not have to share any of the damages that he recovers with his customers unless the contract contains a clause (or a court is persuaded to adopt an imaginative conception of unjust enrichment) that entitles them to any rebate he might receive, probably years later, on an input used in performing his side of the bargain. Nevertheless the Supreme Court has said that the indirect purchaser may sue if he has a cost-plus contract with the direct purchaser.

In the present case, where cost-plus pricing is imposed by public utility regulation rather than by a purely private, purely voluntary contract, the reasons balance out slightly differently, but the case for applying the cost-plus exception of *Illinois Brick* is no weaker once the balance is restruck. The public utility has less to gain from suit than the direct purchaser in the case of the purely private contract. The public utility commission may force the util-

ity to pass on to the consumers any and all damages that the utility recovers, and if it does utilities will have no incentive to sue because they will have nothing to gain from suit. In the present case CILCO finally did sue—but not until 1987, by which time the present suit was far advanced and the statute of limitations with regard to the damages incurred by residential customers in the present suit either had run or was about to run; and the CILCO case has remained dormant pending our decision of the appeal. CILCO seems a most reluctant suitor, and why shouldn't it be? It has little or nothing to gain by such a suit. Indeed, one might argue that public utility regulation (to the extent effective—admittedly a potentially big if) so far identifies a public utility with its customers as to bring the case within the separate exception recognized in *Illinois Brick* for situations in which the direct and indirect purchaser are under common control. See 431 U.S. at 736 n. 16.

Although the amount of gas purchased by a utility's customers is not fixed in their contract with the utility (it would be absurd for consumers to commit to a fixed quantity; their need for gas varies with the weather!), the special character of a public utility eliminates the problem of apportionment, here with respect to the only class of customers that we believe should be allowed to sue, the residential customers. The retail distribution of natural gas through a grid of pipes to the customers' homes or places of business is a natural monopoly, *Omega Satellite Products Co. v. City of Indianapolis*, 694 F.2d 119, 123, 126 (7th Cir. 1982); so, in the absence of regulation, a gas utility would charge a monopoly price. Although the efficacy of public utility rate regulation has been questioned (see, e.g., Stigler & Friedland, *What Can Regulators Regulate? The Case of Electricity*, 5 J. Law & Econ. 1 (1962); Moore, *The Effectiveness of Regulation of Electric Utility Rates*, 36 So. Econ. J. 365 (1970)), the facts of this case suggest, and the parties seem to agree, that residential natural-gas rates in Illinois are lower because of regulation than they would be in an unregulated mar-

ket, implying that CILCO has unused monopoly power in that market, which it exploited by passing on the full overcharge by Panhandle. The situation in the industrial market is different. Some industrial consumers of natural gas have good alternatives, and as to them CILCO apparently had no unused monopoly power that would have enabled it to shift the whole of the cost increase to them. Instead CILCO sought and obtained regulatory permission to reduce its profit margin on sales to these customers, thereby offsetting in part the higher rates enabled by the automatic pass-through provision.

CILCO's dealings with its industrial customers show why the absence of a quantity provision in a contract can make a difference. Since the industrial customers were not obligated to take a fixed (or their required) quantity of natural gas, and since they had competitive alternatives, CILCO's profit-maximizing course of action was to swallow part of the overcharge rather than try to pass it on dollar for dollar in the form of higher rates. But its residential consumers unlike its industrial customers had no good alternatives to natural gas (of which CILCO was the sole purveyor), at least in the short term, and CILCO's profit-maximizing course of action was therefore to allow its rates to them to rise by the exact amount that its gas costs rose as a result of Panhandle's alleged overcharge. It was not only the absence of competition but the presence of regulation that made this the profit-maximizing course of action; regulation is a stand-in for the quantity requirement in an ordinary contract. Apparently rate regulation had succeeded in keeping CILCO's rates to a level where an increase in those rates was bound to increase the firm's revenues because the price increase (1) would not be offset by an equal or greater proportional decline in its sales and (2) would lead to a reduction in the firm's total costs (consumers would buy less, even if only a little less, at the higher price). CILCO therefore had every incentive to raise its price by the full amount allowed by the regulatory commission—which was the full amount of the gas overcharge. And it did it.

The significance of the regulatory setting is that if regulation keeps a utility's rates below what it would like to charge, the utility will raise those rates by the full amount allowed by the regulatory commission unless such an increase would carry the utility above its optimum rate. An unregulated firm would not do that, since as we have noted an unconstrained profit maximizer will always find it in its best interest to swallow a part of any cost increase that it experiences unless its customers are committed to a fixed quantity. It is unclear from the record in this court how generous the commission's allowance was; the commission may have allowed CILCO to double its rates—yet even so, if regulation forced CILCO to charge half or less of its preferred price, CILCO would pass on the entire cost increase. No one suggests that CILCO in fact absorbed any part of the increase, so far as sales to its residential customers were concerned.

The mechanics of the pass-through provision are pertinent. The "Uniform Purchase of Gas Adjustment Clause" that Illinois by statute requires CILCO to include in its contracts not only entitled but directed CILCO, if it paid Panhandle an extra penny per million cubic feet of gas, to add exactly one penny to each customer's bill for every Mcf of gas sold to that customer. So if all of its customers had continued buying the same amount of gas CILCO would have suffered no loss on account of the overcharge. To the extent that CILCO lost residential sales because it was charging a higher price—and no doubt it lost some sales—the loss was not passed on to CILCO's customers (at least in any sufficiently direct way to escape the rule of *Illinois Brick*) and hence is not a component of the customers' damages. But by the same token this is not a case where successive links in the chain of distribution are claiming damages in respect of the same transaction. There are, instead, two completely different sets of transactions. One consists of sales to CILCO followed by resale to its residential customers; on these sales the entire overcharge came to rest on the residential customers and they alone suffered damage and can (on the view we take of

the case) recover damages. The other set of transactions consists of the sales that CILCO lost because some customers balked at the higher rates; on these sales (or rather nonsales) the only loser is CILCO, and only CILCO can sue. There is no suggestion that the residential customers are suing or could sue to recover incidental expenses incurred by reducing their purchases of natural gas—the cost of an extra sweater or a more efficient furnace or better insulation.

To illustrate the distinction between the two types of loss in this case, suppose that the price to CILCO's residential customers before the (alleged) overcharge by Panhandle was $1 per Mcf, the overcharge was 10¢ per Mcf, and by operation of the Uniform Purchase of Gas Adjustment Clause the retail price rose to $1.10 because CILCO made no offsetting reduction in another component of the price, as it did with its industrial customers. And suppose that at the new, higher price CILCO sold only 950,000 Mcf, while at the old price it had sold 1,000,000 Mcf, and that nothing plausibly accounts for the decrease in sales except the price increase, which induced consumers to use less gas. Cf. *Illinois Power Co. v. Commissioner*, 792 F.2d 683, 687-88 (7th Cir. 1986). The loss to each consumer would be the number of Mcf he bought at the new price times 10¢; the loss to CILCO would be its lost profits on the sales it did not make.

Thus there can be no problem of apportionment in the suit on behalf of the residential customers. Those customers are not seeking damages for gas they did not buy, and the damages for the gas they did buy can simply be read off from their gas bills. (Well, almost: at the beginning of each year the utility estimates the amount of rate increase necessary to cover any increase in its gas bill, and there is an adjustment at the end of the year based on actual experience.) Since CILCO can sue for its lost sales (this may be a component of its belatedly filed suit against Panhandle, although that is unclear from the complaint), there can be more than one set of plaintiffs. But each set will be suing in respect of different sales—not, as in *Illinois Brick*, the same sales.

We have said that proof of the indirect purchasers' loss would be straightforward. Proof of CILCO's lost sales would also be straightforward—at least as straightforward as is possible in an antitrust case. It would be a matter of comparing the utility's sales before and after the increase in gas prices, after correcting for other factors besides the increase that might have affected those sales. Such correction is not always easy, but it is a conventional aspect of calculating damages in antitrust cases; it has to be done in every case where the plaintiff claims to have lost sales because of the defendant's unlawful conduct and the defendant argues that the loss was due partly or entirely to other factors. See, e.g., *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 264 (1946); *Fishman v. Estate of Wirtz*, 807 F.2d 520, 551 (7th Cir. 1986); *id.* at 578 (partial dissent); *Olympia Equipment Leasing Co. v. Western Union Telegraph Co.*, 797 F.2d 370, 382-83 (7th Cir. 1986). More important, it is a problem unrelated to the problem the Supreme Court wrestled with in *Hanover* and *Illinois Brick*. The Court was concerned with the situation where two purchasers of the same thing—the initial purchaser and the purchaser from the initial purchaser—are or could be complaining that both had been hurt, and the problem is to apportion the loss between them. Here only the residential consumers can complain about a loss from the overcharge on the gas they bought, while only CILCO can complain about a loss caused by the overcharge on gas that the residential consumers did not buy.

All this is not to say that *Illinois Brick* has no application to cases where the direct purchaser is subject to rate regulation. Although cost-plus is the spirit of rate regulation, the flesh is weak and often therefore the utility has considerable flexibility in pricing, much like an unregulated firm. Indeed, to the extent that it operates free from effective rate regulation—either because it faces competition which constrains its rates below the regulated level (apparently CILCO's situation with its industrial customers), or because the regulators are unable to prevent it

from charging monopoly prices to its captive customers—the utility's situation is identical to that of an unregulated firm. But, if so, this will be revealed in the utility's decision to swallow some of the cost increase, as CILCO did with its residential customers. In the case of its residential customers, regulation must have succeeded in forcing the utility to operate in a region of its demand curve where 100 percent passing on of any cost increase was the optimal strategy for the utility to follow, for that was the strategy it *did* follow.

With the rapid and unanticipated increases in fuel prices during the 1970s, utilities pressed for and obtained the right to include automatic fuel pass-through provisions in their contracts with customers, provisions that would allow the utility to pass on every dollar in higher prices that it paid for gas or other fuels to its customers without going through the time-consuming process of obtaining regulatory authorization to raise rates. Such provisions are also found in unregulated contracts, and should be treated the same there when the contract requires the buyer to take either a fixed quantity or his requirements, since a buyer cannot reduce his purchases under a requirements contract merely because he is dissatisfied with the terms of the contract as they have worked themselves out. See *Empire Gas Corp. v. American Bakeries Co.*, 840 F.2d 1333, 1340-41 (7th Cir. 1988); *Wilsonville Concrete Products v. Todd Building Co.*, 281 Ore. 345, 352, 574 P.2d 1112, 1115 (1978); *Royal Paper Box Co. v. E.R. Apt Shoe Co.*, 290 Mass. 207, 195 N.E. 96 (1935); *Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp.*, 130 F.2d 471, 473-74 (3d Cir. 1942); White & Summers, Handbook of the Law Under the Uniform Commercial Code 126 (2d ed. 1980). (This example shows, by the way, why a rigid test of fixed quantity would be a senseless limitation on the cost-plus exception of *Hanover Shoe* and *Illinois Brick*—a buyer under a requirements contract does not have discretion as to the amount to take under the contract.) If on the other hand the buyer has complete flexibility as to how much to buy, a cost-plus provision

is ineffectual; the buyer can always condition an agreement to buy a specific amount on the seller's agreeing to modify the contract by reducing the price. This is another reason for supposing that an agreement to take a fixed quantity, or, what is equivalent for these purposes, an agreement to take one's requirements, is implicit in the cost-plus exception rather than an independent requirement for invoking it. The unexhausted monopoly power of a regulated utility takes the place of a fixed-quantity or requirements provision. The utility can force the whole of the cost increase through to its residential customers without sacrificing any profits, *and did so.*

But we do not think that the industrial customers should be allowed to sue for damages. By cutting its profit margin to them CILCO raised its price by less than the increase in gas cost, and while the division of that increase between the utility and its industrial customers is easy to ascertain—precisely because the utility was required to get approval for reducing its profit margin—we are unwilling to complicate the administration of *Illinois Brick* by trying to distinguish between difficult and easy apportionment cases. And the Supreme Court seemed unwilling to listen to such arguments. But for every cubic foot of gas bought by a residential customer, we *know* that the whole overcharge was passed on to the customers in accordance with the fuel pass-through provision of their contract with CILCO, and we know why (regulation plus the residential consumers' lack of alternatives).

It might seem an unimportant detail whether a buyer reacts to an overcharge by raising its price by less than the overcharge (as CILCO did with its industrial customers), thus losing fewer customers, or by raising its price by the full overcharge and thereby losing more customers than it would if it swallowed part of the overcharge. But in the second case the problem of apportioning losses on the same sales does not arise. It might also seem impermissible under *Illinois Brick* to inquire into the question whether there really was 100 percent passing on; but the Court announced an exception for cases

where there is a cost-plus contract, and there is such a contract here—the automatic fuel pass-through provision. Although it is not a contract for a fixed quantity or (what is equivalent for purposes of the exception) the buyer's requirements, the existence of public utility regulation is an adequate substitute in the circumstances.

True, we can never be absolutely certain that regulation has resulted in a 100 percent pass through; for all we know, CILCO would have sought a rate increase but for the gas overcharge, and by forbearing to do so in effect absorbed part of the overcharge. But by the same token, the seller under a fixed-quantity cost-plus contract might forbear to insist on a 100 percent pass through in order to curry favor with the buyer for the sake of future deals. No counterfactuals are certain, but the doubts here are too small to warrant our insisting that this potentially serious antitrust violation, which may have caused consumers of natural gas to pay almost $50 million in higher prices, shall go unremedied, as it may if we accept Panhandle's view of the scope of *Illinois Brick*. Whether the cost-plus exception might embrace other situations in which the direct purchaser has a cost-plus contract with the indirect purchasers but the contract does not require the indirect purchasers to buy a fixed quantity (or their requirements) is not a question that we need decide in this case.

The suit on behalf of the residential customers is within the scope of the cost-plus exception to the rule of *Illinois Brick* as we understand it, and we therefore affirm the denial by the district court of the defendant's motion to dismiss the complaint insofar as the complaint seeks damages on behalf of CILCO's residential customers. We reverse insofar as the court allowed suit on behalf of the industrial customers for damages. We express no view of the antitrust merits or of the propriety of the requests for injunctive relief, and we award no costs in this court.

AFFIRMED IN PART AND REVERSED IN PART.

CUDAHY, *Circuit Judge,* concurring:

I concur without reservation in the majority's application of the *Illinois Brick* doctrine to the facts of this case. A bar to indirect purchaser suits would make very little sense if it were extended to the regulated natural gas distribution business where full purchased gas cost pass-through is incorporated in the retail rates. The PGA clause transforms the transaction into the very epitome of a cost-plus contract. Likewise, because residential gas demand is inelastic in the short run due to the unavailability to residential customers of substitute fuels, a rough approximation of a fixed quantity term is present, whether or not required by *Illinois Brick.*

The Natural Gas Pipeline Association of America, in an amicus brief, argues that if the antitrust suit were left to the direct purchaser (CILCO), its regulator (the Illinois Commerce Commission) could and would direct CILCO to pass on the sums recovered to its customers. The customers would, therefore, be in as good a position as if the Attorney General had sued directly on their behalf. I believe this is essentially correct. CILCO has in fact now brought suit in this matter, presumably because the panel decision cast doubt on whether the Attorney General could maintain the action on behalf of consumers.

Under the practical facts of regulation CILCO would ordinarily have a greater incentive to bring this litigation than economic theory suggests. An informal suggestion from its regulators that suit was appropriate to protect customers would ordinarily send CILCO to court. Further, regulation allows CILCO to recognize only its *prudently incurred* expenses for ratemaking purposes. Presumably, a distribution company's purchase of pipeline gas at prices inflated by antitrust violations could be challenged as an imprudent incurrence of operating expenses. An antitrust recovery would at least partially offset any imprudence in the initial purchasing decision. In any event, in its next rate case, the distribution company would be hard pressed to justify its payment of illegally inflated

prices if neither it nor the Attorney General had sought to press the antitrust claim.

Nonetheless, I suspect that considerations such as the difficulty of settlement might lead CILCO to prefer an Attorney General's lawsuit to its own. Presumably, a settlement by the state Attorney General with the pipeline supplier would be accepted as fully arm's length and justifiable. Were CILCO to settle, however, the aggressiveness of its stance might be questioned by the regulators in light of its ongoing relationship with the supplier and, of course, its settlement would in all probability have to be approved by the regulatory authority. It therefore seems to me that, in the final balance, suit by CILCO is not necessarily preferable to suit by the Attorney General on behalf of the residential customers.

FAIRCHILD, *Senior Circuit Judge*, with whom BAUER, *Chief Judge*, and CUMMINGS and MANION, *Circuit Judges*, join, concurring in part, dissenting in part. I concur in reversal as to the treble damage claims on behalf of industrial customers. I respectfully dissent from affirmance with respect to such claims on behalf of residential customers.

The residential customers purchase from CILCO, and are only indirect purchasers from Panhandle, who allegedly overcharged CILCO. Because the rates charged by CILCO reflect, appromixately at least,[1] the actual cost of gas, it is claimed that the residential customers were "injured" so as to be entitled to treble damages under § 4 of the Clayton Act, 15 U.S.C. § 15,[2] by reason of the pass-on of the overcharge.

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[1] The process of adjustment of rates charged by CILCO to rates paid is described in the panel opinion. 839 F.2d at 1208 n.2.

[2] Section 4 provides that

> [A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor . . . and shall recover threefold the damages by him sustained. . . .

The Supreme Court has "held that, except in certain limited circumstances, a direct purchaser suing for treble damages under § 4 of the Clayton Act is injured within the meaning of § 4 by the full amount of the overcharge paid by it . . .". *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 724 (1977) (footnote omitted) (interpreting the rationale of *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481, 494 (1968)). *Hanover Shoe* had rejected an attempt by an antitrust defendant to establish that plaintiff direct buyer had not been "injured" within the meaning of § 4 because the direct buyer had passed on any overcharge. In *Illinois Brick*, plaintiff was asserting a claim on behalf of indirect purchasers that they had been "injured" by a pass-on of an overcharge. The Court reaffirmed *Hanover Shoe* and decided that its root principle (that, with limited exceptions, the full injury of the overcharge falls upon the direct purchaser) must apply to and prevent treble damage claims on behalf of an indirect purchaser, as well as apply to and permit claims of a direct purchaser.

Both *Hanover Shoe* and *Illinois Brick* dealt with the question presented as one of statutory construction of § 4. Indeed in *Illinois Brick*, the Court said,

> In considering whether to cut back or abandon the *Hanover Shoe* rule, we must bear in mind that considerations of *stare decisis* weigh heavily in the area of statutory construction, where Congress is free to change this Court's interpretation of its legislation.

431 U.S. at 736.

Illinois Brick described only two exceptions to its general rule that the direct purchaser is injured by the full amount of the overcharge. One, "where the direct purchaser is owned or controlled by its customer," 431 U.S. at 736, n.16, is clearly inapplicable here. The other, which originated in *Hanover Shoe*, is where an overcharged direct buyer has a pre-existing cost-plus contract for a fixed quantity. 431 U.S. at 736.

Judge Posner's opinion for this court suggests that the reference to "a fixed quantity" does not have controlling significance. *Ante*, pp. 3 and 4. Particular aspects of the *Hanover Shoe* and *Illinois Brick* opinions persuade me otherwise.

The *Hanover Shoe* opinion, in recognizing that "a pre-existing 'cost-plus' contract" might provide an exception to its rule against a pass-on defense, did not expressly require a fixed quantity element. 392 U.S. at 494. That element may well have been implied, for the Court referred to the cost-plus contract as "thus making it easy to prove that [the direct buyer] has not been damaged." *Ibid.* In *Illinois Brick*, Justice White, who wrote for the Court in both cases, expressly referred to the fixed quantity element and took pains to explain why it was important:

> But this Court in *Hanover Shoe* indicated the narrow scope it intended for any exception to its rule barring pass-on defenses by citing, as the only example of a situation where the defense might be permitted, a pre-existing cost-plus contract. In such a situation, the purchaser is insulated from any decrease in its sales as a result of attempting to pass on the overcharge, because its customer is committed to buying a fixed quantity regardless of price. The effect of the overcharge is essentially determined in advance, without reference to the interaction of supply and demand that complicates the determination in the general case.

431 U.S. at 735-36.

This court's opinion concedes that no doubt CILCO lost residential sales because of the higher price, and because of the overcharge if there was one. *Ante*, p. 9. It follows from *Hanover Shoe* and *Illinois Brick* that when some injury falls on the direct purchaser because of the overcharge, it all does.

After considering and rejecting proposed exceptions, the Court said "As we have noted, *supra* at 735-736, *Hanover Shoe* itself implicitly discouraged the creation of exceptions to its rule barring pass-on defenses, and we adhere to the narrow scope of exemption indicated by our decision there." 431 U.S. at 745.

As I read *Illinois Brick*, the Supreme Court did not leave it to the discretion of the lower courts to create new exceptions for situations which fall within some range of approximation of the exceptions defined by the Court. And that is what this court appears to be doing with respect to the claims of the residential customers.

APPENDIX B

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 85-2601

STATE OF ILLINOIS, ex rel. NEIL F. HARTIGAN, Attorney General of the State of Illinois, in its proprietary capacity, in its *parens patriae* capacity, and in its representative capacity,

Plaintiff-Appellee,

v.

PANHANDLE EASTERN PIPE LINE COMPANY, a Delaware corporation,

Defendant-Appellant.

Appeal from the United States District Court
for the Central District of Illinois, Peoria Division.
No. 84-1048—**Michael M. Mihm**, *Judge.*

ARGUED FEBRUARY 26, 1986—DECIDED JANUARY 22, 1988

Before BAUER, *Chief Circuit Judge*, POSNER, *Circuit Judge*, and FAIRCHILD, *Senior Circuit Judge.*

FAIRCHILD, *Senior Circuit Judge.* This appeal involves a treble damage action on behalf of Illinois consumers of natural gas. These consumers buy from distributors, who buy from defendant Panhandle, an interstate pipeline company. It is alleged that Panhandle violated the antitrust laws and overcharged the distributors. Under public utility

regulation, one component of the price the distributors charge the consumers is the cost of gas to the distributors. It is claimed that Panhandle's overcharge is thus passed on to the consumers; because they are only indirect purchasers from defendant, they can claim injury in a treble damage action only if their purchases are within an exception to the rule of *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

Plaintiff argues, in substance, that the public utility regulation creates a sufficiently close approximation of a pre-existing cost-plus contract for a fixed quantity so as to fulfill that exception. 431 U.S. at 736. The district court agreed and denied Panhandle's motion to dismiss. Permission for this appeal was obtained pursuant to 28 U.S.C. § 1292(b). We reverse.

Plaintiff is the state of Illinois. It is both a direct and indirect purchaser of natural gas from Panhandle, but the State's claims as to direct purchases are not before us. The state also sues as *parens patriae* on behalf of natural persons residing in Illinois[1] who are indirect purchasers from Panhandle, and also brings a class action on behalf of all indirect purchasers from Panhandle.

The complaint did not spell out a claim that these indirect purchasers fall within an exception to *Illinois Brick*. Plaintiff alleged only that it had been injured in its business and property. Facts illuminating the claim of an exception to *Illinois Brick* have, however, been brought before the district court. There has been no argument that the pleading was deficient, that the claim of exception was waived, or that the issue cannot be decided on the present record.

Central Illinois Light Company (CILCO) is one of the distributors of Panhandle gas (along with smaller quantities of gas of other producers). There are distributors other than CILCO, and their customers are among the consumers represented by the State in this action. The parties have concentrated their discussion, however, on

[1] 15 U.S.C. § 15c.

the CILCO facts, and appear to accept them as representative.

CILCO's monthly bills to its customers contain three components: (1) an amount per customer not dependent on the amount of gas used; (2) an amount per therm of gas used, calculated to recover a share of fixed expenses and provide a profit margin; and (3) a gas charge factor. Through a process of estimate in advance and retrospective adjustment,[2] the gas charge factor approximates the actual cost of gas, but without perfect accuracy at any one time. As plaintiff looks at it, component (3) represents the "cost" and components (1) and (2) the "plus" in analogizing to the cost-plus exception in *Illinois Brick*. The arrangement has no element which corresponds to the agreed quantity element of that exception.

For the purpose of discussion, it is convenient to separate CILCO's customers into two groups:

(a) *Sixteen Large Industrial Customers*

These customers are able to switch to alternate fuel. In 1983, CILCO was threatened with the loss of these customers because of the high cost of gas. A loss of up to 20% of its sales was expected. CILCO responded by obtaining permission from the regulators to reduce its profit margin and thus its price for gas for a four-month period. Although in form there was no reduction in component (3), and component (3) included the unlawful over-

[2] Under the Purchase Gas Adjustment (PGA) process, CILCO estimates the purchases, costs and sales in a future period, computes the cost for that period and adjusts its rates prospectively to reflect the estimate. At the end of each year, the estimated and actual costs are reconciled. In 1983, CILCO overcollected more than $3 million, and in 1984 more than $1 million. Overcollections are refunded through adjustments in the following year. A customer who terminates service before the refund does not receive it. A customer who used less gas in the refund period than he used in the overcollection period does not receive a full refund.

charge if there was any, the reduction in the profit portion of component (2), and consequently in the total price, made it unreal to say that the full amount of any overcharge was passed on. Thus there was necessarily an injury to CILCO if some part of the cost resulted from an unlawful overcharge. Hence, it is especially clear as to these customers that there is no *Illinois Brick* exception. The relationship between CILCO and these industrial customers did not approach a cost-plus contract for a fixed quantity. Moreover, if the industrial customer were permitted to press a claim on a pass-on theory, it could not claim that it suffered the entire injury. Apportionment between the direct and indirect purchaser would be required, precisely the process rejected by the *Illinois Brick* Court. 431 U.S. at 746.

(b) *Residential and Other Smaller Quantity Consumers*

These consumers, like the large industrial customers, have no obligation to purchase any particular quantity of gas. Their demand is elastic to some degree, and a high price (including an unlawful overcharge, if any) will reduce CILCO's sales and profits. Consumers of this type can to some extent use alternative fuels, and they have resorted to conservation in response to an increased price.

CILCO sold 46,400,000 Mcf of gas in 1982, but its sales decreased by 14.7% in 1983 and 2.3% in 1984. It lost 1,061 customers in 1983 and 693 in 1984. Increased prices thus reduced CILCO's sales and profits as well as being passed on to customers to the extent of sales made. Assuming that the prices charged CILCO by Panhandle included an unlawful overcharge, it had adverse consequences on both CILCO and its customers. Again, if the customers' claims were to be recognized, there must be apportionment of recovery between the direct and indirect purchasers.

As the *Illinois Brick* Court observed, with respect to the pre-existing cost-plus contract,

> [i]n such a situation, the purchaser is insulated from any decrease in its sales as a result of attempting

> to pass on the overcharge, because its customer is committed to buying a fixed quantity regardless of price. The effect of the overcharge is essentially determined in advance without reference to the interaction of supply and demand that complicates the determination in the general case.

431 U.S. at 736.

As is evident, plaintiff here cannot really claim that CILCO's relationship with its customers falls literally within the confines of a pre-existing cost-plus contract for a fixed quantity. Plaintiff does, however, assert that the relationship is the "functional equivalent" of a cost-plus contract for a fixed quantity, and relies on *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148 (5th Cir. 1979).

In *Beef Industry*, defendants were retail chains which allegedly conspired to fix at low levels the prices to be paid packers for beef. The packers allegedly computed the price they paid cattlemen by a formula based on the price the packers were to receive. The plaintiffs were cattlemen, claiming that the unlawful undercharge was passed on to them. The Fifth Circuit held that plaintiffs had alleged the functional equivalent of cost-plus contracts, and thus an exception to the *Illinois Brick* rule which would otherwise have prevented recovery by an indirect seller.[3]

In *Beef Industry*, the court noted that economic forces made the supply of fat cattle "inelastic in the short term." 600 F.2d at 1154. It is not clear, however, that the court relied on this inelasticity as the functional equivalent of the predetermination of volume inherent in a cost-plus contract for a fixed quantity. "Functional equivalence is not lost simply because the proponent of passing-on theory

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[3] On remand, it developed that plaintiff could not, in fact, demonstrate the habitual use by the packers of a predetermined formula, as alleged, preventing the packers from absorption of some of the undercharge. Judgment was granted to defendants. 542 F. Supp. 1122 (N.D. Tex. 1982), *affirmed* 710 F.2d 216 (5th Cir. 1983).

cannot demonstrate that the middleman suffered no loss in volume as the result of raising the price to his customers." 600 F.2d at 1164.

In our view, however, the *Illinois Brick* Court regarded the predetermination of quantity as an essential element of the exception. Thus there could be a "functional equivalent" of a cost-plus contract for a fixed quantity only where factors such as obligations imposed by law or economic forces or a combination of them made inevitable an exact passing on of price variation applied to a predetermined quantity to the same extent as a contract so providing.[4]

In *Hanover Shoe v. United Shoe Machinery Corp.*, 392 U.S. 481, 494 (1968), in suggesting that "a pre-existing 'cost-plus' contract" would be an exception to the *Hanover* rule against a pass-on defense, there was no express reference to the fixed quantity element of the cost-plus contract. In *Illinois Brick*, in describing the same exception,

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[4] Plaintiff has cited a case involving the regulated distribution of natural gas and a PGA mechanism similar to the one before us. *New Mexico Natural Gas*, CCH 1982-1 Trade Cases ¶ 64,685, p.73,714 (D. N.M. 1982). Treble damage actions were brought by and on behalf of consumers who purchased from a defendant distributor, who purchased from defendant producers. Producer defendants sought summary judgment based on *Illinois Brick*. The New Mexico court denied the motion, finding an exception because two policy considerations underlying *Illinois Brick* were not significant in the case before it. One of the policy considerations was the difficulty in tracing the pass-on of an overcharge. The New Mexico court decided that the PGA clauses obviated this concern. The second policy consideration was the risk of multiple liability if indirect as well as direct purchasers could sue. The New Mexico court found this concern was not significant in the case before it. The court relied on the fact, which it acknowledged was unusual, that the distributor was a defendant and alleged to be a partner with defendant producers in the price-fixing conspiracy, and would be precluded from suing its co-conspirators. The New Mexico court did not address the question whether the demand for gas is elastic and the distributor (direct purchaser) may have been injured by loss of sales volume. The *New Mexico Gas* case is distinguishable.

there was such a reference, and an explanation of its importance:

> In such a situation, the [direct] purchaser is insulated from any decrease in its sales as a result of attempting to pass on the overcharge, because its customer is committed to buying a fixed quantity regardless of price. . . .
>
> As we have noted, *supra*, at 735-736, *Hanover Shoe* itself implicitly discouraged the creation of exceptions to its rule barring pass-on defenses, and we adhere to the narrow scope of exemption indicated by our decision there.

431 U.S. at 736, 745.

It appears in the case before us that Panhandle's alleged antitrust violations would produce actual injury to both the direct and indirect purchasers. The indirect purchasers pay a higher price per therm of gas because Panhandle's price is reflected in the price they pay. CILCO, the direct purchaser, is injured by loss of sales and profit. Where this is so, we conclude that *Illinois Brick* does not permit the indirect purchasers to sue for their part of the injury. It may be that because of the utility regulation requiring that CILCO's cost per therm be passed through to its customers, the avoidance of multiple recovery against Panhandle will be less complex than in a case where the direct purchaser's price to the indirect purchaser will be the result of less channeled market forces. It may be easier to separate accurately the injury to the indirect purchasers from the injury to CILCO. *Illinois Brick* did not, however, leave it to the discretion of the lower courts to expand the exceptions to include situations within some range of approximation of the exceptions defined in *Illinois Brick*. We read *Illinois Brick* as requiring that in this, as well as more complex cases, it is only the direct purchaser who may bring a treble damage action.

The order appealed from is REVERSED, with directions to dismiss the complaint as to all claims by or on behalf of indirect purchasers.

POSNER, *Circuit Judge*, concurring and dissenting. Central Illinois Light Company, a retail distributor of natural gas, bought natural gas from the defendant, an interstate gas pipeline company, at prices allegedly inflated because of violations of the antitrust laws by the defendant, and resold the gas to its customers. The question—and it is a difficult one—is whether any of those customers can sue the pipeline company on the theory that CILCO passed on the entire cost of the overcharge to them in the form of higher rates.

Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968), held that it is not a defense to a damages action that a buyer forced to pay a higher price because of the seller's antitrust violation passed on the cost of the violation to his own customers by raising his prices to them—unless the buyer had a cost-plus contract with them. *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), announced a corollary to *Hanover Shoe*: the "indirect purchaser" (that is, the customer of the buyer, who is the "direct purchaser") cannot sue to recover the part of the overcharge that the buyer passed on to him. The Court again recognized an exception for the cost-plus contract, noting that it insulates the direct purchaser from "any decrease in its sales as a result of attempting to pass on the overcharge, because its customer is committed to buying a fixed quantity regardless of price." *Id.* at 736. Fastening on the words "fixed quantity," my brethren hold that the cost-plus exception is never available when the indirect purchasers are free to vary the quantity they buy from the direct purchaser.

This is not the first court to confine the exception so. See *Mid-West Paper Products Co. v. Continental Group, Inc.*, 596 F.2d 573, 577 n. 9, 580 (3d Cir. 1979); *In re Midwest Milk Monopolization Litigation*, 730 F.2d 528, 533 (8th Cir. 1984); *Lefrak v. Arabian American Oil Co.*, 487 F. Supp. 808, 819 (E.D.N.Y. 1980); cf. *Arizona v. Shamrock Foods Co.*, 729 F.2d 1208, 1212 n. 2 (9th Cir. 1984). But the previous cases involved privately negotiated cost-plus contracts rather than cost-plus contractual pro-

visions required by public utility regulation, which may make a difference as we shall see. Nor is it clear from the Supreme Court's opinion in *Illinois Brick* whether the reference to fixed quantity was intended to state an independent requirement of the cost-plus exception or merely to describe a normal contract situation, where the buyer's obligation is to buy the quantity specified in the contract. Not all contracts have this feature, but there is no indication that the Court meant to distinguish between fixed-quantity and variable-quantity contracts. Not only is the reference to fixed quantity dictum, because the case did not involve a fixed-quantity contract; the Court's entire discussion of cost-plus contracts is dictum, because the case did not involve a cost-plus contract but merely an argument (which the Court rejected, see 431 U.S. at 744) that a buyer's practice of rule-of-thumb cost-plus pricing should be enough to allow his customers to sue.

Although several district courts have rejected an exception for cost-plus regulation, see *Go-Tane Service Stations, Inc. v. Ashland Oil, Inc.*, 508 F. Supp. 200, 204 (N.D. Ill. 1981); *City of Cleveland v. Cleveland Electric, Illuminating Co.*, 538 F. Supp. 1320 (N.D. Ohio 1980); *U.S. Oil Co. v. Koch Refining Co.*, 518 F. Supp. 957 (E.D. Wis. 1981), the cases are factually distinguishable; and in the case whose facts are most like those of the present case the district court held that indirect purchasers could sue, because public utility regulation had created "a straight cost passthrough." *In re New Mexico Natural Gas Antitrust Litigation*, 1982-1 Trade Cases ¶ 64,685, at p. 73,722 (D.N. Mex. 1982). Cf. *County of Oakland v. City of Detroit*, 628 F. Supp. 610, 613 (E.D. Mich. 1986); *Illinois v. Borg, Inc.*, 548 F. Supp. 972, 975-76 (N.D. Ill. 1982). (An additional wrinkle in that case, however, was that the direct purchasers were in cahoots with the defendants; this was an independent ground for allowing the indirect purchasers to sue.) It is possible to allow indirect purchasers to sue in a case such as the present one without embracing the ill-defined "functional equivalent" approach of *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148

(5th Cir. 1979); see also, e.g., *Gulf Oil Corp. v. Dyke*, 734 F.2d 797, 809 (T.E.C.A. 1984), effectively criticized in *In re Midwest Milk Monopolization Litigation*, 529 F. Supp. 1326, 1337-38 (W.D. Mo. 1982), aff'd, 730 F.2d 528 (8th Cir. 1984); Comment, *A Legal and Economic Analysis of the Cost-Plus Contract Exception in Hanover Shoe and Illinois Brick*, 47 U. Chi. L. Rev. 743, 756-70 (1980); cf. *Abbott Dairies Division v. Butz*, 584 F.2d 12, 16-17 (3d Cir. 1978), and found to be inapplicable to conditions in the beef industry itself in *In re Beef Industry Antitrust Litigation*, 710 F.2d 216, 219-20 (5th Cir. 1983). However, for reasons to be explained, I would not allow all the indirect purchasers in this case to sue—just the residential consumers.

To determine whether (or to what extent) this case is within the rule of *Illinois Brick*, we must consider the reasons for confining the right to sue to the direct purchaser; for it is the reasons behind a rule that determine its scope. First, the direct purchaser is closer to the violation, hence more likely to discover it. We therefore want to make sure that he has a powerful incentive to bring the violator to book, and we do this by holding out to him the prospect of recovering the entire damages for the violation if he wins the suit. Second, it is difficult to apportion damages between direct and indirect purchasers by the methods of litigation. A direct purchaser who finds himself paying a higher price for inputs would love to pass on all of the additional cost to his customers in the form of a higher price, but he can't, because a price that much higher will so reduce the demand for his product that his profits will fall unacceptably. The optimal adjustment to the increased cost of the input will be a price increase smaller than the increase in input cost. But this means that the increased cost will be divided between the two tiers, the direct and indirect purchasers—but in what proportions will often be hard to determine. An additional complication is that the higher input price may induce the direct purchaser to use more of an alternative input, and this substitution will affect the proportion of the initial overcharge that the direct purchaser can recoup.

Where the direct purchaser has a cost-plus contract with his customers that requires them to buy a fixed quantity, the reasons for confining the right to seek damages to the direct purchaser cease to be fully persuasive. There is no longer a problem of apportionment, because the whole of any price increase will have been passed on to the customers. Yet the other reason for confining the right to seek damages to the direct purchaser survives: he has better information about the violation. And, despite the cost-plus nature of the contract, he has everything to gain from suing. He will not have to share any of the damages that he recovers with his customers unless the contract contains a clause (or a court is persuaded to adopt an imaginative conception of unjust enrichment) that entitles them to any rebate which he might receive, probably years later, on an input used in performing his side of the bargain.

In the present case, where cost-plus pricing is the product of public utility regulation rather than a purely private contract, the reasons balance out slightly differently, but the case for applying the cost-plus exception of *Illinois Brick* is no weaker once the balance is restruck. The public utility has less to gain from suit than the direct purchaser in the purely private contract case, because the public utility commission may force the utility to pass on to the consumers any and all damages that the utility recovers. If so, the utility will have no incentive to sue; and it is no surprise that CILCO did not sue (and apparently the statute of limitations has now run). And although the amount of gas purchased by the utility's customers is not fixed in their contract with the utility, there is no problem of apportionment with respect to the only class of customers that I would allow to sue, the residential customers.

To see this, notice first that the retail distribution of natural gas through a grid of pipes to the customers' homes or places of business is a classic natural monopoly, *Omega Satellite Products Co. v. City of Indianapolis*, 694 F.2d 119, 123, 126 (7th Cir. 1982); so, in the absence of regulation, a gas utility would charge a monopoly price.

Although the efficacy of public utility regulation has been questioned (see, e.g., Stigler & Friedland, *What Can Regulators Regulate? The Case of Electricity*, 5 J. Law & Econ. 1 (1962); Moore, *The Effectiveness of Regulation of Electric Utility Rates*, 36 So. Econ. J. 365 (1970)), the facts of this case suggest, and the parties seem to agree, that residential natural-gas rates in Illinois are lower because of regulation than they would be in an unregulated market, implying that CILCO has unused monopoly power in that market. The situation in the industrial market is different. Some industrial consumers of natural gas have good alternatives, and as to them CILCO apparently had no unused monopoly power that would enable it to shift the whole of the cost increase to them. Instead CILCO sought and obtained regulatory permission to reduce its profit margin on sales to these customers, thereby offsetting in part the higher rates enabled by the automatic pass-through provision.

The residential consumers have no good alternatives to natural gas, and as to them CILCO's profit-maximizing course of action was, it appears, to allow its rates to rise by the exact amount of the increase in its gas costs. Rate regulation evidently had succeeded in keeping CILCO's rates to a level where the demand for its gas was inelastic. In this region of a firm's demand curve, an increase in price will by definition increase the firm's revenues, because the price increase will not be offset by an equal or greater proportional decline in quantity demanded—that is what it means to say that demand is inelastic. And since the increase in price will reduce the firm's costs (by causing demand for its product to fall, since consumers will buy less at the higher price) at the same time that it causes the firm's revenues to rise, the firm's profits must increase. CILCO had therefore (with a qualification to be considered shortly) every incentive to raise its price by the full amount allowed by the regulatory commission—that is, by the full amount of the gas overcharge. This implies that the entire overcharge was passed on to the utility's residential consumers on all sales made to these consumers.

Put more simply, if because of regulation a utility's rates are below what it would like to charge, it will raise those rates by the full amount allowed by the regulatory commission unless such an increase would carry the utility above its optimal level. It is unclear from the record filed in this court how large the allowance was; conceivably the commission allowed CILCO to double its rates—yet even so, if regulation had forced CILCO to charge half or less of its preferred price, CILCO would pass through the entire cost increase. No one suggests that CILCO in fact absorbed *any* of the increase, so far as sales to its residential customers were concerned.

The mechanics of the pass-through provision are important. The "Uniform Purchase of Gas Adjustment Clause" that the Illinois commission required CILCO to include in its contracts not only entitled but directed CILCO, if it paid Panhandle Eastern Pipe Line Company an extra penny per million cubic feet of gas, to add exactly one penny to each customer's bill for every Mcf of gas sold to that customer. So if all of its customers had continued buying the same amount of gas, CILCO would have suffered no loss on account of the overcharge. To the extent that the utility lost residential sales because it was charging a higher price—and no doubt it lost some sales, because demand is never perfectly inelastic—the loss was a loss to the utility, was not passed on to its customers (at least in any sufficiently direct way to escape the rule of *Illinois Brick*), and hence is not an allowable factor in computing the customers' damages.

To illustrate the distinction between the two types of loss, suppose that the price to CILCO's residential customers before the overcharge to CILCO by Panhandle Eastern Pipe Line Company was $1 per Mcf, the overcharge was 10¢ per Mcf, and therefore by operation of the Uniform Purchase of Gas Adjustment Clause the retail price rose to $1.10 because CILCO made no offsetting reduction in another component of the price, as it did with its industrial customers. Suppose further that at the new, higher price CILCO sold only one million Mcf, whereas

at the old price it had sold 950,000 Mcf; and suppose that nothing plausibly accounts for the decrease in sales except the price increase, which induced consumers to use less gas. Cf. *Illinois Power Co. v. Commissioner*, 792 F.2d 683, 687-88 (7th Cir. 1986). The loss to each consumer would be the number of Mcf he bought at the new price times 10¢; the loss to CILCO would be its lost profits on the sales it did not make.

Clearly, then, there is no problem of apportionment in the suit by the residential customers. Those customers are not seeking damages for gas they didn't buy, and the damages for the gas they did buy can simply be read off from their gas bills. (Well, almost: at the beginning of each year the utility estimates the amount of rate increase necessary to cover any increase in its gas bill, and there is an adjustment at the end of the year based on actual experience.) The only problem would come if CILCO had tried to sue for its lost sales, for then there would be more than one set of plaintiffs. But each set would be suing in respect of different sales—not, as in a *Hanover Shoe* or *Illinois Brick* case, the same sales. There would be no haggling over how much of the overcharge on each sale had been borne ultimately by the direct purchaser and how much by the indirect purchaser. And the proof of CILCO's lost sales would be straightforward—at least as straightforward as is possible in an antitrust case. It would involve comparing the utility's sales before and after the increase in gas prices, correcting for other factors, besides the increase, that might have affected those sales. Such correction is not always easy but is a conventional aspect of calculating damages in antitrust cases; it has to be done in every case where the plaintiff claims to have lost sales because of the defendant's unlawful conduct and the defendant argues that the loss was due partly or entirely to other factors. More important, it is a computational problem that has nothing to do with the problem that concerned the Supreme Court in *Hanover* and *Illinois Brick*. To repeat, the Court was concerned with the situation where two purchasers of the

same thing—the initial purchaser and the purchaser from the initial purchaser—are or could be complaining that both had been hurt, and the problem is to apportion the loss between them. Here only the residential consumers could complain about a loss from the overcharge on the gas they bought, while only CILCO could complain about a loss caused by the overcharge on gas that the residential consumers did not buy.

Finally, unless the indirect purchasers are allowed to sue, the antitrust violation is likely to go unremedied, because the direct purchaser has even less incentive to sue than in a contractual cost-plus setting. CILCO might have an incentive to sue in respect of its lost sales (a distinct item of damages, as we have seen), but this would depend on how many sales it lost and on whether it would have to pass through any damages to its customers. In fact the incentive was not enough to induce it to sue.

I am not suggesting that the rule of *Illinois Brick* has no application to cases where the direct purchaser is subject to rate regulation. Although cost-plus is the spirit of rate regulation, the flesh is weak and often therefore the utility has considerable flexibility in pricing, much like an unregulated firm. Indeed, to the extent that the utility operates free from effective rate regulation—either because it faces competition that depresses its rates below the regulated level (apparently CILCO's situation with its industrial customers), or because the regulators are unable to prevent it from charging monopoly prices to its captive customers—its situation is identical to that of an unregulated seller. But in the case of CILCO's residential customers, regulation apparently succeeded in forcing the utility to operate deep in the inelastic region of its demand curve, with the result that 100 percent passing on of any cost increase was the optimal strategy for the utility to follow.

With the rapid and unanticipated increases in fuel prices during the 1970s, utilities pressed for and obtained the right to include automatic fuel pass-through provisions in their contracts with customers, provisions that would

allow the utility to pass on every dollar in higher prices that it paid for gas or other fuels to its customers without going through the time-consuming process of obtaining regulatory authorization to raise rates. Such provisions are also found in unregulated contracts and should be treated the same there when the contract requires the buyer to take either a fixed quantity or his requirements, since a buyer cannot reduce his purchases under a requirements contract merely because he is dissatisfied with the terms of the contract as they have worked themselves out. See *Wilsonville Concrete Products v. Todd Building Co.*, 281 Ore. 345, 352, 574 P.2d 1112, 1115 (1978); *Royal Paper Box Co. v. E.R. Apt Shoe Co.*, 290 Mass. 107, 195 N.E. 96 (1935); *Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp.*, 130 F.2d 471, 473-74 (3d Cir. 1942); White & Summers, Handbook of the Law Under the Uniform Commercial Code 126 (2d ed. 1980). (This example shows, by the way, why a rigid requirement of fixed quantity would be a senseless limitation on the cost-plus exception of *Hanover-Shoe* and *Illinois Brick*: a buyer under a requirements contract does not have discretion as to the amount to take under the contract.) If on the other hand the buyer has complete flexibility as to how much to buy, a cost-plus provision is ineffectual; the buyer can always condition an agreement to buy a specific amount on the seller's agreeing to modify the contract by reducing the price. This is another reason for supposing that an agreement to take a fixed quantity, or, what is equivalent for these purposes, an agreement to take one's requirements, is implicit in the cost-plus exception rather than being an independent requirement for invoking it. The unexhausted monopoly power of a regulated utility takes the place of a fixed-quantity or requirements provision. The utility can force the whole of the cost increase through to its residential customers without sacrificing any profits, *and did so.*

I would not allow the industrial customers to sue, however. By cutting its profit margin to them, CILCO raised its price by less than the increase in gas cost; and while

the apportionment of that increase between the utility and its industrial customers is easy to make—precisely because the utility was required to get approval for reducing its profit margin—I would be reluctant to complicate the administration of the *Illinois Brick* rule by trying to distinguish between difficult and easy apportionment cases. And the Court seemed unwilling to listen to such arguments. However, for every cubic foot of gas bought by a residential customer, we know that the whole overcharge was passed on to the customers, in accordance with the fuel pass-through provision.

It might seem an unimportant detail whether a buyer reacts to an overcharge by raising its price by less than the overcharge (as CILCO did with its industrial customers), thus losing fewer customers, or by raising its price by the full overcharge and thereby losing more customers than it would if it swallowed part of the overcharge. But in the second case the problem of apportioning losses on the same sales does not arise. It might also seem impermissible under *Illinois Brick* to inquire into the amount of passing on but the Court made an explicit exception for cases where there is a cost-plus contract. There is such a contract here—the automatic fuel pass-through provision—and although it is not a contract for a fixed quantity or (what I contend is equivalent for purposes of the exception) the buyer's requirements, the existence of public utility regulation is an adequate substitute in the circumstances.

We can never be absolutely certain that regulation has resulted in a 100 percent pass through; for all we know, CILCO would have sought a rate increase but for the gas overcharge, and by forbearing to do so in effect absorbed part of the overcharge. But by the same token, the seller under a fixed-quantity cost-plus contract might forbear to insist on a 100 percent pass through in order to curry favor with the buyer for the sake of future deals. No counterfactuals are certain, but the doubts here are too small to warrant us in insisting that this potentially serious antitrust violation, which may have imposed on con-

sumers of natural gas aggregate damages of almost $50 million, go unremedied, as apparently it will.

The suit by the residential customers is within the scope of the cost-plus exception to the rule of *Illinois Brick*, and I would therefore affirm the denial by the district court of the defendant's motion to dismiss the complaint insofar as the complaint seeks damages on behalf of CILCO's residential customers.

APPENDIX C

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF ILLINOIS

STATE OF ILLINOIS, ex rel NEIL F. HARTIGAN, Attorney General of the State of Illinois in its proprietary capacity and in its *parens patriae* capacity and in its representative capacity,

Plaintiff,

v.

PANHANDLE EASTERN PIPE LINE COMPANY, a Delaware corporation,

Defendant.

No. 84-1048

ORDER

Defendant Panhandle Eastern Pipe Line Company ("Panhandle") moves the Court for an order dismissing Plaintiff's claims in the Third Amended Complaint brought on behalf of indirect purchasers of natural gas from Panhandle on the ground that such claims are barred by *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977). Defendant has renewed its motion to dismiss based on *Illinois Brick* at this time because of recent deposition testimony concerning the implementation of the "purchase gas adjustment" provision ("PGA") and because the State seeks certification of a class including gas purchasers other than natural persons. Plaintiff State of Illinois moves for partial summary judgment that, as a matter of law, any anti-competitive overcharge by Panhandle to the Central Illi-

nois Light Company ("CILCO"), a local distribution company, is passed through in its entirety to CILCO's customers.

In support of its Motion to Dismiss, Panhandle argues that CILCO has absorbed part of Panhandle's gas increases with regard to industrial users. In recent deposition testimony, John F. Weisburch, CILCO's Manager of Commercial Office and former Manager of the Rate Department, testified that each calendar year, CILCO estimates the purchases, costs and sales of natural gas for the upcoming year and calculates PGA factors for the upcoming year on that basis. If CILCO accurately determines both the date and amount of the gas cost increases and decreases, its customers will pay the actual cost of gas. It is more common, however, that CILCO's estimate is incorrect, and an undercharge or overcharge to CILCO's customers results. When that occurs, a reconciliation proceeding is held before the Illinois Commerce Commission ("ICC") and any overcharge or shortage is compensated for during the next 12-month period. In 1983, for instance, CILCO over-collected approximately $3 million from its customers. That amount was refunded in 12 monthly installments beginning in April, 1984 as a credit on the April and subsequent bills. In 1984, CILCO over estimated its gas costs by approximately $1 million.

Weisburch testified that the PGA mechanism can break down with respect to exact reconciliation to individual customers. For example, if a customer purchased gas during 1983 but terminated service in April of 1984, he or she would not receive a refund even if he or she had paid the overcharge.

Notwithstanding the PGA mechanism, Panhandle argues that CILCO can adjust and has adjusted its rates and margins to absorb Panhandle rate increases. In 1983, CILCO implemented "rate 7" in order to keep some large industrial customers on its system at a time when the cost of gas was high. The implementation of the rate reduced the industrial customer's bill by two cents per therm, causing CILCO to receive and thus absorb $2.7

million less in revenues than it would have otherwise received. Panhandle contends that the reduction in margin or the loss of sales which might have occurred in the absence of that reduction, to the extent caused by illegal overcharges, constitutes an element of damages not passed through by CILCO to its customers. Thus, unless its Motion to Dismiss is granted, Panhandle argues, there exists a potential for duplicative recovery.

In further support of its argument that *Illinois Brick* bars the Plaintiff's claims, Panhandle states that CILCO is not insulated from decreases in its sales to customers as a consequence of passing on overcharges. Plaintiff concedes that consumers have resorted to conservation as a result of the high price of natural gas in central Illinois. Between 1982 and 1983, during the period that Panhandle allegedly was overcharging CILCO, CILCO suffered a decrease in sales of 14.7%. For these and other reasons, Defendant Panhandle argues that *Illinois Brick* precludes the Plaintiff's claims.

The Court rejects Panhandle's argument. *Illinois Brick* held that a pass-on theory could not be used offensively by an indirect purchaser plaintiff against an alleged violator of §4 of the Clayton Act, 15 U.S.C. §15. The effect of the Court's ruling was that an overcharged direct purchaser would be deemed for purposes of §4 of the Act to have suffered the full injury from the overcharge. If a pass-on theory could not be used by a defendant as a defense against a suit by a direct purchaser under *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), the Supreme Court reasoned, similarly, an indirect purchaser could not use the theory to recover damages from the same defendant.

Illinois Brick expressed concern over the difficult problem of tracing the effect of an overcharge through various levels in the chain of distribution and a concern with the risk of multiple liability for the defendant if use of the pass-on theory was allowed. The court, however, specified two exceptions to the bar against suits by indirect purchasers. First, an exception was made for pre-existing

cost-plus contracts where an indirect purchaser buys a predetermined quantity of price-fixed goods from a direct purchaser. 431 U.S. 732 n.12. Second, the Court carved out an exception where a direct purchaser is owned or controlled by its customer. 431 U.S. 736 n.16. In commenting on the first exception, the Fifth Circuit noted:

> "The [*Illinois Brick*] Court meant the scope of the exception to be narrow, but it did not imply that only cases involving cost-plus contracts qualify. . . . *Hanover Shoe* and *Illinois Brick* permit the assertion of passing-on in situations that are the functional equivalent of the cost-plus contract case (citation omitted)."

In re Beef Industry Antitrust Litigation, 600 F.2d 1148, 1163 (5th Cir. 1979).

The policies underlying the Supreme Court's decision in *Illinois Brick* would not be served by application of the *Illinois Brick* rule to the case at bar. In *Illinois Brick*, the concrete block which was the subject of the alleged overcharge passed through two separate levels in the chain of distribution before reaching the ultimate purchaser. The court stated that:

> "Indeed, the evidentiary complexities and uncertainties involved in the defensive use of pass-on against a direct purchaser are multiplied in the offensive use of pass-on by a plaintiff several steps removed from the defendant in the chain of distribution. The demonstration of how much of the overcharge was passed on by the first purchaser must be repeated at each point at which the price-fixed goods changed hands before they reached the plaintiff. (Footnote omitted)." 431 U.S. at 732-33.

Illinois Brick did not contemplate a factual situation involving a heavily regulated industry like the natural gas industry. The PGA eliminates the complexities and uncertainties of tracing the alleged overcharge through levels of the distribution chain. By virtue of the PGA, CILCO passes on to the consumer, dollar for dollar, all increases and decreases in the pipeline's gas charge. The PGA obvi-

ates any significant tracing or multiple liability problems which would mandate the application of the *Illinois Brick* rule. The PGA, like "Rule 20" and "Rate Rider #4" in *In re New Mexico Natural Gas Antitrust Litigation*, Trade Cas. (CCH) para. 64,685, at p. 73,722 (D. N.Mex. 1982):

> " 'makes easy the normally complicated task of demonstrating that the overcharge has not been absorbed by the direct purchaser.' That is precisely the rationale given by the Supreme Court in discussing the 'cost-plus' exception recognized originally in *Hanover Shoe*. *Illinois Brick*, 431 U.S. at 732 n.12."

In the monthly bill received by CILCO consumers, CILCO's PGA billing item is segregated and entirely separate from CILCO's operational costs, expenses, and approved rate of return which are set forth in its monthly customer service charge and in its charge per therm of gas used.

In *New Mexico Natural Gas*, as here, the purchase gas adjustment account was subject to periodic adjustment. The court noted, however, that the balancing or adjusting account "does not alter the ultimate result. The cost of gas factor is passed directly through to New Mexico consumers." *Id.* at p. 73,722 n.15. Similarly, CILCO's annual reconciliation with the ICC does not alter the ultimate result; the cost of gas sold is still passed directly through to CILCO's consumers. The fact that certain individual consumers will not recoup the exact amount that they may have overpaid in a previous year will not bar the State of Illinois from seeking alleged overcharges in a *parens patriae* action on behalf of CILCO's customers.

Here, as in *New Mexico Natural Gas*, the indirect purchasers, CILCO's customers, are in effect the direct purchasers of Panhandle's gas. This is not the usual situation existing in a free market system, with which the *Illinois Brick* case deals. The alleged overcharges are easily traceable by virtue of the PGA. Panhandle urges, however, that CILCO also allegedly was injured by virtue of (1) its loss of sales volume and (2) by its temporary

1983 reduction of its profit margin on sales to industrial customers with fuel switching capability following Panhandle's increase in gas costs to all CILCO consumers ("rate 7"). These, however, are separable items of damage constituting CILCO's alleged injury and are not being sought by the State of Illinois in this litigation. As stated in *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148, 1164 (5th Cir. 1979):

> " '. . . any situation in which [the impact of] the overcharge is essentially determined in advance 'without reference to the interactions of supply and demand' would function in the same way' [as the cost-plus contract case]. (Citation omitted). When the impact of an overcharge on a middleman's pricing decisions can be so determined, the uncertainties involved in resorting to general economic theorems are avoided and the clarity of the evidence virtually eliminates the possibility of overlapping liabilities as the result of inconsistent verdicts in separate lawsuits. Functional equivalence is not lost simply because the proponent of passing-on theory cannot demonstrate that the middleman suffered no loss in volume as the result of raising the price to his customers (footnote omitted). In the cost-plus contract itself, the middleman is likely to have suffered a loss of volume and hence profits as a result of the overcharge. His higher selling price will likely have caused potential customers to forego his product (citation omitted). The middleman's loss of volume and the indirect purchaser's absorbtion of the overcharge are wholly separable items of damage."

See also *State of Illinois v. Borg, Inc.*, 548 F.Supp. 972, 975 (N.D. Ill. 1982) ("Where that tracing-apportionment problem is not present—where the indirect purchaser's damages are plainly ascertainable without having to reconstruct the direct purchaser's probable competitive market response to the overcharge—the reason for the underlying *Illinois Brick* rule vanishes.")

The rate 7 situation is troublesome in terms of the prospect of multiple litigation and liability. However, the traditional operation of the PGA and the policy considera-

tions involved here, in the Court's opinion, require a finding that the *Illinois Brick* rule does not apply. In *Illinois Brick*, the court commented that:

> "(W)e understand *Hanover Shoe* as resting on the judgment that the antitrust laws will be more effectively enforced by concentrating the full recovery for the overcharge in the direct purchasers rather than by allowing every potential plaintiff affected by the overcharge to sue only for the amount it could show was absorbed by it." 431 U.S. at 734-35.

The court later stated that:

> "The concern in *Hanover Shoe* for the complexity that would be introduced into treble-damages suits if pass-on theories were permitted was closely related to the Court's concern for the reduction in the effectiveness of those suits if brought by indirect purchasers with a small stake in the outcome than that of direct purchasers suing for the full amount of the overcharge." 431 U.S. at 745.

In the case at bar, the customers of CILCO, represented by the State of Illinois, have a far greater interest in pursuing an antitrust suit against Panhandle than does CILCO. The State has alleged damages of $47 million due to anticompetitive overcharges borne by CILCO's customers. Under "rate 7," by comparison, CILCO absorbed an alleged $2.7 million loss of revenue. Further, calculation of CILCO's loss of sales resulting from Panhandle's alleged overcharge is far more difficult to ascertain than is the direct pass-through of alleged overcharges by virtue of the PGA.

The *Illinois Brick* court noted that Section 4 of the Clayton Act has a purpose in addition to deterring violators and depriving them of their fruits of their illegality:

> "It is also designed to compensate victims of antitrust violations for their injuries (citation omitted). *Hanover Shoe* does further the goal of compensation to the extent that the direct purchaser absorbs at least some and often most of the overcharge." 431 U.S. at 746.

Again, the case at bar is factually inapposite from the market situation contemplated in *Illinois Brick*. In the case at bar, the indirect purchasers, CILCO's customers, have absorbed most of the alleged overcharge. It would frustrate one of the major purposes of antitrust laws to allow CILCO to recover the alleged $47 million anticompetitive overcharge which was born almost exclusively by CILCO's customers.

On the basis of the foregoing, Panhandle's Motion to Dismiss the Third Amended Complaint for "Indirect Purchasers" will be denied. Plaintiff's motion for partial summary judgment will be granted. At oral argument, the Court indicated that it did not accept fully the Plaintiff's statement of undisputed material facts. However, the Court finds that *Illinois Brick* does not bar Plaintiff's action as an indirect purchaser. This ruling does not preclude a finding that CILCO's customers have not sustained the entire amount of the alleged overcharge.

The Court believes that its Order denying Defendant's Motion to Dismiss Plaintiff's claims on behalf of indirect purchasers and holding that those claims are not barred by *Illinois Brick Co. v. Illinois* "involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation . . . ." 28 U.S.C. §1292(b).

Accordingly, IT IS HEREBY ORDERED:

1. Panhandle's Motion to Dismiss the Third Amended Complaint for "Indirect Purchasers" is DENIED. That portion of this Order dealing with the Motion to Dismiss is certified for interlocutory appeal.

2. Plaintiff's Motion for Partial Summary Judgment is GRANTED.

ORDER ENTERED: July 29th, 1985.

/s/ MICHAEL M. MIHM
United States District Judge

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF ILLINOIS

STATE OF ILLINOIS, ex rel NEIL F. HARTIGAN, Attorney General of the State of Illinois in its proprietary capacity and in its *parens patriae* capacity and in its representative capacity,

Plaintiff,

v.

PANHANDLE EASTERN PIPE LINE COMPANY, a Delaware corporation,

Defendant.

No. 84-1048

ORDER

This Court's Order of July 29, 1985 is hereby amended. Page 3, line 5, and following, is amended to read as follows: ". . . The implementation of the rate reduced the industrial customer's bill by two cents per therm, causing CILCO to receive and thus absorb an alleged $935,527.15 or an alleged $2.7 million[1] less in revenues than it otherwise would have received . . . ."

IT IS SO ORDERED.

ORDER ENTERED: August 2, 1985.

/s/ MICHAEL M. MIHM
United States District Judge

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[1] Plaintiff argues that the $2.7 million figure referred to by Panhandle as the CILCO rate margin reduction was in fact an annualized figure which assumed "rate 7" was in effect for 12 months. Plaintiff alleges that in fact "rate 7" was in effect 4½ months during which time CILCO sold under "rate 7" 36,687,351 therms at a reduced margin of 2.55¢ per therm which resulted in a total profit reduction of $935,527.15. See CILCO's '983 Annual Report to the Illinois Commerce Commission, ICC Form 21, p. 517, Line No. 6, column (e).

APPENDIX D

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF ILLINOIS

STATE OF ILLINOIS, ex rel NEIL F. HARTIGAN, Attorney General of the State of Illinois in its proprietary capacity and in its *parens patriae* capacity and in its representative capacity,

Plaintiff,

v.

PANHANDLE EASTERN PIPE LINE COMPANY, a Delaware corporation,

Defendant.

No. 84-1048

ORDER REGARDING MOTION TO RECONSIDER

This Court has at various stages of this litigation been confronted with the question of the applicability of *Hanover Shoe Incorporated v. United Shoe Machinery Corporation*, 392 U.S. 481 (1968), and *Illinois Brick Company v. Illinois*, 431 U.S. 720 (1977), to the indirect purchaser claims asserted by the Plaintiff. On two prior occasions I have ruled that *Illinois Brick* does not bar Plaintiff's indirect purchaser claims. Defendant has now moved to have this Court reconsider those earlier rulings, on the basis of the following new information: (1) The filing of a lawsuit by CILCO against Defendant (Central District of Illinois No. 87-1073), claiming antitrust violations and

seeking, at paragraph 25(a) of the prayer for relief, recovery of all overcharges paid by CILCO customers. (2) The evidence adduced at trial concerning the "AP Rider," whereby CILCO in effect gave a break on price to certain industrial end users. CILCO adopted and implemented Rider AP in early 1986 (DX 156) which authorized CILCO to reduce its margin and discount its price to its commercial and industrial customers to compete with fuel oil. It is claimed that, consequently, all gas costs are not passed through by CILCO to its customers, and the LDC can manipulate its rates to avoid passing the entire cost of gas to its customers. (3) The testimony at trial that because of higher gas costs, CILCO's sales have decreased significantly from about 40 BCF in 1983 to approximately 31 BCF in 1986, a decrease of approximately 25%.

This Court is well aware of the rulings of the Supreme Court in *Hanover Shoe* and *Illinois Brick*. I am also familiar with the various subsequent cases which counsel have tendered to the Court in support of their respective positions. I have studied those cases at length. Having considered all of the arguments and evidence presented, the Court finds that the Motion to Reconsider should be and is DENIED. I come to this conclusion with some apprehension but with the firm conviction that the decision is the right one.

I say apprehension, because defense counsel's arguments suggest that this Court's prior rulings in regard to this matter fly in the face of Supreme Court, Appellate Court, and District Court precedent. Obviously, this Court is not a law unto itself. I am bound to follow controlling precedent, whether I agree with it or not. I do not seek to evade or avoid my duty to follow controlling authority.

Nor, on the other hand, do I seek to attempt to avoid the difficult task of applying the law as I understand it to those fact situations which (1) may not have been fully contemplated by what is characterized as the controlling authority, or (2) may constitute the "functional equivalent" of an exception to the rule as recognized by the controlling authority.

In *Hanover Shoe*, the Supreme Court established that pass-on was not available as a defense for an alleged antitrust violator who had been sued by a direct purchaser. One of the policy reasons stated for that decision appears at 392 U.S. 493:

> "Equally difficult to determine, in the real economic world rather than an economist's hypothetical model, is what effect a change in a company's price will have on its total sales."

On the next page, 494, the Court set out "the exception":

> "We recognize that there might be *situations* (emphasis added)—for example, when an overcharged buyer has a pre-existing 'cost plus' contract, thus making it easy to prove that he has not been damaged—where the considerations requiring that the pass-on defense not be permitted in this case would not be present. We also recognize that where no differential can be proved between the price unlawfully charged and some price the seller was required by law to charge, establishing damages might require a showing of loss of profits to the buyer."

The wording from this quote by the Supreme Court indicates that there might be "situations" (plural), where the "considerations requiring that the pass-on defense not be permitted in this case would not be present." The *Hanover Shoe* Court also suggested "cost plus contracts" as an example of, but not the only situation, in which the pass-on can be easily shown.

In *Illinois Brick* the Court addressed the question of whether or not the pass-on theory might be used offensively by an indirect purchaser plaintiff against an alleged violator. On that point, the Court quickly concluded, "Whatever rule is to be adopted regarding pass-on in antitrust damages actions, it must apply equally to plaintiffs and defendants." *Illinois Brick*, page 728. Secondly, the Court reaffirmed the finding of *Hanover Shoe* that the overcharged direct purchaser is the party "injured in his business or property" within the meaning of §4 of the

Clayton Act, thereby prohibiting a situation where "any party in the chain may sue to recover the fraction of the overcharge allegedly absorbed by it." *Illinois Brick*, page 729. The result of this was that the Court held that offensive use of the pass-on theory by an indirect purchaser against an alleged violator could only be used in a situation where the same theory could be used as a defense by the alleged violator in an action brought by direct purchasers. Page 735. The policy consideration behind this was clearly set out at pages 731-732:

> "The principal basis for the decision in *Hanover Shoe* was the court's perception of the uncertainties and difficulties in analyzing price and output decisions 'in the real economic world rather than an economist's hypothetical model,' 392 U.S. at 493, and of the costs to the judicial system in the efficient enforcement of the antitrust laws of attempting to reconstruct those decisions in the courtroom. This perception that the attempt to trace the complex economic adjustments to a change in the cost of a particular factor of production would greatly complicate and reduce the effectiveness of already protracted treble damages proceedings applies with no less force to the assertion of pass-on theories by plaintiffs than it does to the assertion by defendants."

At page 733, n. 13:

> "In our view, the difficulty of reconstructing the pricing decisions of intermediate purchasers at each step in the chain beyond the direct purchaser *generally* (emphasis added) will outweigh any gain in simplicity from not having to litigate the effects of the passed-on overcharge on the direct purchaser's volume."

On page 736 of the opinion, where the Court discusses the "exception" (a pre-existing cost-plus contract), the Court makes it clear that the reason for the exception is because in such a contract the purchaser:

> "is insulated from any decrease in its sales as a result of attempting to pass on the overcharge, because its

> customer is committed to buying a fixed quantity regardless of price. The effect of the overcharge is essentially determined in advance without reference to the interaction of supply and demand that complicates the determination in the general case."

In sum, *Hanover Shoe* and *Illinois Brick* together stand for the proposition that pass-on will ordinarily not be allowed to be used either defensively or offensively in antitrust damages litigation, and offensive use of a pass-on theory against an alleged violator can only be used if the same situation would allow the violator to interpose pass-on as a defense in an action brought by the direct purchaser.

I believe that the concerns giving rise to the general rule in *Illinois Brick* are not present in this case because of the fact that we are dealing here with a heavily regulated industry, and because of the existence of the PGA, Rate 7, and AP Rider. In this case, the increase in price for indirect purchasers caused by the overcharge is easily calculated and is "essentially determined in advance, without reference to the interaction of supply and demand that complicates the determination in the general case." The PGA filing requires that the cost of gas be passed-through to the indirect purchaser. Rate 7 and the AP Rider are both rates that are determined in advance and susceptible of simple mathematical computation regarding the amount of discount involved. These ingredients taken together constitute the type of "cost-plus contract" referred to in the *Hanover Shoe* decision. The Court further believes that this type of factual situation, in the context of a heavily regulated industry, constitutes the functional equivalent of a "fixed quantity cost-plus contract" as referred to in *Illinois Brick*. *See, In re Beef Industry Antitrust Litigation*, 600 F.2d 1148, 1165 (5th Cir. 1979). Because the Court believes that we are dealing here with a functional equivalent of the exception discussed in *Hanover Shoe* and *Illinois Brick*, *Illinois Brick* does not act as a bar to the indirect purchaser claims in this case. This ruling merely constitutes an affirmation of the statement

in *Illinois Brick* that "whatever rule is to be adopted regarding pass-on in an antitrust damages action it must apply equally to plaintiffs and defendants." *Illinois Brick*, page 728.

This case does not present an example of a problem of determining how much of the overcharge was absorbed by which level of the distribution chain. *Illinois Brick*'s discussion of the difficulty of applying economic theories to the real economic world does not apply to the factual situation in this case. The indirect purchasers' claims that they bore the illegal overcharge do not depend upon a complex economic theory or analysis.

The discussion by the Supreme Court in the *Illinois Brick* decision regarding enforcement concerns is completely appropriate. However, in the context of this case, where it has been determined by this Court that the exception to the *Illinois Brick* rule applies, those enforcement concerns are not thwarted or diluted. My only regret is that the direct purchasers were not joined as parties in this litigation, so that the underlying question of antitrust liability could have been determined in one lawsuit.

In the case of *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148 (5th Cir. 1979) (*Beef I*), the Fifth Circuit reversed a district court's granting of defendant's motion to dismiss on the grounds that:

> "The allegations of the complaint state a case within the 'cost-plus exception.' The complaint sufficiently alleged that the impact of the retail chain's price charges upon the pricing decision of the packers is determined in advance without regard to the interactions of supply and demand." 600 F.2d at 1165.

In the case of *In re Beef Industry Antitrust Litigation*, 710 F.2d 216 (1983) (*Beef II*), the Fifth Circuit affirmed the district court's granting of summary judgment to the defendant on the grounds that "the defendant's overwhelming proof demonstrates that other factors beyond the yellow sheet influenced the packers pricing decision." This Court has previously adopted the "functional equiva-

lent" analysis in *Beef I*. Unlike *Beef II*, the proof in our litigation has not demonstrated that other factors beyond the cost of gas influenced CILCO's pricing decisions. And in fact, any detraction from a 100% pass-through (Rate 7 and Rate AP) was predetermined, approved by the ICC, and capable of simple mathematical computation. As stated in *Beef II*, 710 F.2d at 220, "The nature of a cost-plus contract is such that there is absolute certainty as to the application and the amount of the pass-on." Because of the procedures implemented in this case through the PGA, Rate 7, and the AP Rider, there is absolute certainty as to the application and the amount of the pass-on.

The fact that CILCO has now filed a lawsuit which claims, among other prayers for relief, that it is entitled to recover the entire alleged overcharge in the amount of $72 million, does not mean that the Defendant is not entitled to assert a defense as to that claim on the basis of pass-on.

Concerning the Plaintiff's claims that the second exception noted in *Illinois Brick* also has application here, the Court totally rejects that notion. That exception, which appears at page 736, n. 16, provides as follows:

> "Another situation in which market forces have been superseded and the pass-on defense might be permitted is where the direct purchaser is owned or controlled by its customers."

In spite of Plaintiff's fanciful arguments on this point, this Court believes that the relationship between the customers of LDC and the LDC is clearly not one where the LDC is "owned or controlled by its customers."

The Court does agree with defense counsel that the cases of *Blue Shield of Virginia v. McCready*, 457 U.S. 465, and *Associated General Contractors of California Inc. v. California State Council of Carpenters, et al.*, 459 U.S. 519, are not particularly on point and tend to deal more with the question of remoteness as opposed to the question of direct versus indirect purchasers.

In reference to the case of *Carter v. Berger*, 777 F.2d 1173 (7th Cir. 1985), Defendants are certainly correct that the wording in that opinion is very strong. On page 1175, Judge Easterbrook states:

> "The response of antitrust law is stark: The direct purchaser recovers from the wrongdoer the full overcharge, trebled, even if it also recovered the whole overcharge by raising its own prices. *Hanover Shoe* (citation omitted). The indirect purchaser recovers nothing, even if it bore the whole overcharge and even if the direct purchaser did not sue. *Illinois Brick* (citation omitted)."

On page 1177 of the *Carter* case, Judge Easterbrook goes on to observe that:

> ". . . [T]he court observed in *Illinois Brick* that it is exceptionally difficult to determine just how much of any 'overcharge is passed on' by the direct buyer to its customers. Passing on depends on the elastics of supply and demand for the products that the initial buyers produce. . . . The more customers are able to substitute other things for the products of the direct purchaser, the less the overcharge will be passed on; the more competitive the industry of the initial buyer, the more will be passed on. The Supreme Court thought the calculation of those elastics so daunting that it saw best not to try."

In our case, we are not dealing with a general market situation. We are dealing instead with a highly regulated industry, where the cost of gas must be passed-through, and where any adjustments in the nature of discounts must be given prior approval and are mathematically determined to the penny. Consequently, the difficulties referred to by Judge Easterbrook in the *Carter* case are not present. This is especially true in view of the fact that the Court, by this ruling, specifically reaffirms the belief that the fact situation in this case constitutes a functional equivalent of the exception to the *Illinois Brick* rule. Were we dealing with the general market situation

here, Judge Easterbrook's comments in the *Carter* case would be completely controlling.

In a similar vein, in the case of *Tip Top Farms, Inc. v. Dairylea Coop, Inc.*, 479 N.Y.S.2d 99, 105, the court said:

> "Allocating the amount of the illegal overcharge for milk cartons which Dairylea passed on to plaintiffs cannot be ascertained without reference to complex market interactions of supply and demand."

Here, because of the PGA and the predetermination by the ICC of discounting factors such as Rate 7 and the AP Rider, the amount of overcharge passed on to Plaintiffs can be ascertained without reference to complex market interactions of supply and demand.

CONCLUSION

If this were a regular market situation there is no question that the Defendant's position would be appropriate and the Motion to Reconsider would be granted, resulting in the dismissal of all indirect purchaser claims. Because of the very peculiar nature of the factual circumstances within which this litigation occurs, that is, the highly regulated natural gas industry, this Court sincerely believes that the PGA, Rate 7, and AP Rider constitute a cost-plus equivalent which avoids the application of the general *Illinois Brick* rule. The Court fully adopts the reasoning employed in its July 29, 1985 order and its October 1986 order and directs that the Motion to Reconsider filed by the Defendant be DENIED.

It is so ordered this 19th day of June, 1987.

/s/ MICHAEL M. MIHM
United States District Judge

APPENDIX E

REHEARD EN BANC

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

July 18, 1988.

Before

Hon. WILLIAM J. BAUER, *Chief Judge*
Hon. WALTER J. CUMMINGS, *Circuit Judge*
Hon. RICHARD D. CUDAHY, *Circuit Judge*
Hon. RICHARD A. POSNER, *Circuit Judge*
Hon. JOHN L. COFFEY, *Circuit Judge*
Hon. JOEL M. FLAUM, *Circuit Judge*
Hon. KENNETH F. RIPPLE, *Circuit Judge*
Hon. DANIEL A. MANION, *Circuit Judge*
Hon. MICHAEL S. KANNE, *Circuit Judge*
Hon. THOMAS E. FAIRCHILD, *Senior Circuit Judge*

No. 85-2601

STATE OF ILLINOIS, ex rel., NEIL F. HARTIGAN, Attorney General of the State of Illinois, in its proprietary capacity and in its *parens patriae* capacity and in its representative capacity,

Plaintiff-Appellee,

v.

PANHANDLE EASTERN PIPE LINE COMPANY, a Delaware corporation,

Defendant-Appellant.

Appeal from the United States District Court
for the Central District of Illinois, Peoria Division.
No. 84 C 1048—**Michael M. Mihm,** *Judge.*

This cause was reheard on the record from the United States District Court for the Central District of Illinois, Peoria Division, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED IN PART, and REVERSED IN PART, with no costs awarded in this Court, in accordance with the opinion of this Court filed this date.

APPENDIX F

[Filed March 16, 1987]

IN THE
UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF ILLINOIS
PEORIA DIVISION

CENTRAL ILLINOIS LIGHT COMPANY, an Illinois corporation,

Plaintiff,

vs.

PANHANDLE EASTERN PIPE LINE Co., a Delaware corporation,

Defendant.

No. 87-1073
EQUITABLE RELIEF SOUGHT

COMPLAINT FOR EQUITABLE RELIEF AND DAMAGES AND DEMAND FOR JURY TRIAL

Plaintiff, CENTRAL ILLINOIS LIGHT COMPANY ("CILCO") brings this complaint against defendant, PANHANDLE EASTERN PIPE LINE CO. ("PANHANDLE") under the antitrust laws of the United States and of the State of Illinois.

JURISDICTION AND VENUE

1. This Complaint is brought under Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§1 and 2, and Section 3 of the Illinois Antitrust Act, ¶60-3, Chap. 38, Ill. Rev.

Stat. (1982). This Court has jurisdiction pursuant to 15 U.S.C. §§4 and 15, and 28 U.S.C. §§1331, 1332 and 1337.

2. Venue is proper in the Central District of Illinois pursuant to 28 U.S.C. §1391(a) and (c) and 15 U.S.C. §§15 and 22.

PARTIES

3. CILCO is a corporation incorporated under the laws of the State of Illinois with its principal place of business in Peoria, Illinois, and is a citizen of the State of Illinois. CILCO is engaged, among other things, in the purchase, distribution and sale at retail of natural gas as a public utility in the State of Illinois. CILCO's primary gas service area is situated in Putnam, Marshall, Stark, Peoria, Knox, Woodford, Tazewell, Logan, McLean, DeWitt, Mason, Fulton, Sangamon, Douglas, Edgar, Vermilion, Champaign and Moultrie Counties in Illinois. The southern portion of CILCO's primary gas service area includes the municipalities of Springfield, Lincoln, Scottland, Tuscola, Arcola, Villa Grove and Pesotum and surrounding areas and municipalities, and is referred to as the Springfield gas service area, and the northern portion includes the municipalities of Peoria, Pekin, East Peoria, Washington, Lacon and Henry and surrounding areas and municipalities, and is referred to as the Peoria-Pekin gas service area. In addition to its primary gas service area, CILCO serves three smaller areas in central and east central Illinois. These smaller service areas are not interconnected with one another or with CILCO's primary gas service area, and it is not economically practical to interconnect them.

4. Panhandle is a corporation incorporated under the laws of the State of Delaware with its principal operating offices in Kansas City, Missouri and its executive offices in Houston, Texas and is a citizen of States other than Illinois. Panhandle is engaged, among other things, in the purchase, transportation and sale of natural gas in interstate commerce, and owns and operates an integrated natural gas pipeline system situated in the States of

Texas, Oklahoma, Kansas, Missouri, Illinois, Indiana, Ohio, Michigan, Colorado and Wyoming. Panhandle does business in the Central District of Illinois, and at all times material hereto, owned, operated and controlled and still owns, operates and controls the only interstate pipeline system with access to CILCO's Springfield gas service area. Until November of 1985, Panhandle's pipeline was also the only interstate pipeline system with access to CILCO's Peoria-Pekin gas service area.

5. Panhandle purchases gas from extensive acreage located in the States of Texas, Oklahoma, Kansas, Colorado, Wyoming, and offshore Texas and Louisiana and from other interstate pipeline systems. Within the State of Illinois, Panhandle makes sales of natural gas, at wholesale, to utility and municipal distributors, and also makes direct sales of natural gas at retail to certain end-users. In 1985, Illinois sales by Panhandle to distributors amounted to approximately $246.7 million, while Panhandle's sales directly to end-users in Illinois totalled an estimated $105.2 million.

6. Panhandle forms an integral part of a larger vertically integrated enterprise and is a wholly owned subsidiary of Panhandle Eastern Corporation ("Panhandle Eastern"). In addition to its ownership of Panhandle, Panhandle Eastern owns two coal companies, a company engaged in the regasification and sale of liquefied natural gas ("LNG"), two LNG supertankers, and investments in related businesses.

7. Panhandle itself is vertically integrated in that through wholly-owned subsidiaries, Panhandle Trading Company and PanMark Gas Company ("PanMark"), Panhandle has sold and still sells additional quantities of natural gas directly to end-users located in the relevant geographic market, in direct competition with CILCO. Panhandle also owns 100% of the common stock of a second interstate pipe line company.

DEFINITIONS

8. As used herein:

(a) "Distributor" means an entity, including CILCO, that operates a local pipeline system for purposes of delivering natural gas to end-users. The natural gas delivered to the end-users may be purchased by the distributor directly from a producer, or a pipeline company or some other supplier, and then resold by the distributor to the end-users. In such cases, the distributor is a purchaser at wholesale and a seller at retail, as well as a transporter of natural gas. Alternatively, the natural gas delivered to the end-users may be purchased by the end-users directly from a producer or a pipeline company or some other supplier that is competing with the distributor in the retail sale of gas, in which case the distributor's function is limited to the transportation of the natural gas.

(b) "End-user" is a person or entity which uses or consumes natural gas purchased at retail.

(c) "MCF" means one thousand cubic feet.

(d) "Natural gas" or "gas" means a gaseous hydrocarbon consisting primarily of methane found in subsurface geological formations.

(e) "Pipeline system" means pipeline and other equipment suitable for the purpose of transporting natural gas from one point to another.

(f) "Pipeline company" means a company, including PANHANDLE, engaged in the operation of an interstate pipeline system and in the purchase, transportation and sale of natural gas in interstate commerce. Natural gas transported by the pipeline company may be purchased by the pipeline company and resold at wholesale or retail, in which case the pipeline company acts as a purchaser and seller as well as a transporter of the natural gas. Alternatively, the gas transported by the pipeline company may be owned

by others, in which case the pipeline company's function is limited to the transportation of the natural gas.

(g) "Producer" means an entity that develops natural gas wells.

(h) "Relevant geographic market" means CILCO's primary gas service area, and includes two sub-markets, the Springfield gas service area and the Peoria-Pekin gas service area.

(i) "Product market" means the transportation of natural gas or the sale of natural gas to distributors and end-users.

(j) "Relevant market" means the relevant geographic market and product market collectively.

BACKGROUND FACTS

9. CILCO currently delivers approximately 40 million MCF of natural gas per year to more than 180,000 end-users, consisting of residential, commercial and industrial customers. Approximately 98% of that gas is delivered to end-users located in the relevant geographic market.

10. Historically, more than 99% of CILCO's deliveries of natural gas in the relevant geographic market represented sales by CILCO at retail. PANHANDLE controlled the only interstate pipeline system with access to the relevant geographic market, and almost 100% of the gas purchased by CILCO for resale in the relevant geographic market was purchased from PANHANDLE, and, except for small amounts of propane gas manufactured by CILCO during periods of peak use, all gas delivered by CILCO to end-users in the relevant geographic market was first delivered to CILCO by PANHANDLE.

11. CILCO's purchases of natural gas from PANHANDLE have been made under a contract executed in 1970. The contract was amended in 1984 to reduce CILCO's daily contract demands by 10%, in exchange for extending the term of the contract from October 31, 1988 to De-

cember 31, 1989. A copy of the contract is attached to this Complaint as Exhibit A and is incorporated herein by reference.

12. As set forth in CILCO's contract with PANHANDLE, CILCO's purchases of natural gas were under Panhandle's General Service rate. The only other rate available to CILCO was PANHANDLE's Limited Service rate, which would have been substantially less favorable to CILCO economically and operationally. Section 1.9 of the General Terms and Conditions, maintained by Panhandle as part of its tariff, contained what is commonly known as a sole supplier provision, which has been used by Panhandle to prevent General Service customers from purchasing natural gas from any supplier other than Panhandle. Section 1.9 provided as follows:

> "General Service Buyer. General Service Buyer is any buyer which does not purchase gas from any other natural-gas company, as defined in the Natural Gas Act, for distribution in areas served with Seller's gas; provided, however, a Buyer under the General Service Rate Schedule which seeks from Seller an increase in contract demand and Seller is unable to supply the increase in contract demand, then such Buyer may purchase natural gas from other natural-gas companies but shall remain a General Service Buyer under this Tariff."

13. Beginning in September of 1982, Panhandle's charges for natural gas sold to CILCO began to accelerate rapidly in comparison with the charges of other interstate pipelines and in comparison with the cost of gas offered for sale by producers. PANHANDLE's charges for gas increased approximately 70% from August 31, 1982 through March of 1983. Consequently, it became desirable for CILCO to reduce its gas costs by purchasing natural gas directly from producers and transporting that gas through Panhandle's interstate pipeline system to CILCO's distribution system for resale to end-users.

14. On March 17, 1983, CILCO requested Panhandle to transport to CILCO's distribution system 8,200 MCF of natural gas per day to be purchased by CILCO directly from producers. However, PANHANDLE refused to transport natural gas to CILCO for resale if the gas were not purchased from PANHANDLE.

15. If PANHANDLE had agreed to transport natural gas purchased by CILCO from suppliers other than PANHANDLE:

(a) CILCO would have competed with PANHANDLE for the purchase of natural gas directly from producers;

(b) CILCO would have purchased natural gas directly from producers and transported the gas to CILCO's distribution system at a total delivered cost substantially below the commodity price charged by PANHANDLE for sale of natural gas at wholesale;

(c) CILCO would have offered natural gas at retail to end-users in the relevant geographic market at prices that were competitive with those offered by PANHANDLE and its PanMark and Panhandle Trading Company subsidiaries, and by producers and others, who competed with CILCO in the retail sale of gas to end-users within the relevant geographic market.

(d) With lower total costs of natural gas, CILCO's retail rates for natural gas would have been reduced, resulting in increased sales of natural gas by CILCO to end-users in the relevant geographic market.

16. On various occasions after March 17, 1983, CILCO again requested PANHANDLE to transport natural gas which CILCO would purchase from sources other than PANHANDLE. Except for limited amounts, not exceeding 10% of daily contract demands under limited circumstances and for limited periods, Panhandle refused and continued to refuse, until March 12, 1987, to transport natural gas to CILCO for resale if the natural gas were not purchased from Panhandle.

17. Under date of February 15, 1984, CILCO obtained authority from the Illinois Commerce Commission to acquire the necessary right-of-way and to construct a pipeline approximately 22 miles in length from the northern terminus of CILCO's Peoria-Pekin gas service area at Henry, Illinois to Princeton, Illinois to connect with an interstate pipeline owned and operated by Natural Gas Pipeline Company of America ("NGPL"). Construction of the extension was completed in November of 1985, at a total cost of approximately $9 million for the right-of-way and the construction.

18. When NGPL requested approval from the Federal Energy Regulatory Commission ("FERC") to interconnect with CILCO at Princeton, Panhandle intervened in the proceeding and objected to any approval that would permit CILCO or end-users in the relevant geographic market to receive gas through the interconnection except in emergencies. Before NGPL's request was acted upon by FERC, Panhandle privately communicated to CILCO a demand that CILCO surrender control of the interconnection to Panhandle. When CILCO refused, Panhandle persisted with its objection before FERC, and when approval of the interconnection was later granted by FERC, the approval limited use of the interconnection to periods of emergency on CILCO's pipeline system.

19. In order to avoid the restriction placed by FERC on the use of the initial interconnection, in October of 1986 a second interconnection was made between CILCO's Henry-Princeton pipeline extension and NGPL's interstate pipeline at Princeton, through which NGPL is authorized by FERC to transport natural gas to CILCO for resale.

20. In December of 1986, an additional interconnection was made at Princeton, Illinois, between CILCO's Henry-Princeton pipeline extension and the interstate pipeline of ANR Pipeline Company ("ANR"). ANR is authorized by FERC to use the interconnection to transport gas to CILCO for resale.

21. From time to time prior to and after October of 1986, Panhandle advised CILCO, directly and indirectly, that if CILCO purchased natural gas from any person or entity other than Panhandle for purposes of resale to end-users in the relevant geographic market, CILCO would be transferred by Panhandle from the General Service rate to Panhandle's Limited Service rate. If CILCO were transferred to the Limited Service rate, CILCO could be required by Panhandle to pay millions of dollars annually in additional charges. Such additional charges would continue to be imposed whether CILCO purchased a single molecule or all of its gas requirements from others, and such charges would be in addition to the cost of any gas purchased from others. As a result of Panhandle's threatened action, CILCO did not purchase gas from any supplier for delivery through the interconnections with NGPL or ANR until after February 20, 1987, the date when FERC issued its Order in consolidated Docket Nos. RP 82-58-000 and RP 82-105-000 striking down the sole supplier restriction in Panhandle's General Service tariff on the ground that it was "anticompetitive on its face and must be eliminated." Until February 20, 1987, CILCO was totally dependent upon Panhandle for delivery of natural gas to the Peoria-Pekin submarket, and was and still is totally dependent upon Panhandle for delivery of natural gas to the Springfield submarket.

22. Whenever CILCO, as an end-user of gas, and other end-users in the relevant geographic area requested Panhandle to transport gas for end-use, Panhandle refused to transport until CILCO and the other end-user applicants complied with Panhandle's "Transportation Guidelines," under which suppliers designated by Panhandle were given a right of first refusal to supply gas at the price offered to the applicants by other suppliers of gas.

23. By reason of Panhandle's refusal to transport natural gas purchased by CILCO at wholesale from any supplier other than Panhandle, and by reason of Panhandle's threats to transfer CILCO from the General Service rate to the Limited Service rate if CILCO purchased at wholesale

from any supplier other than Panhandle, competition was stifled and trade was restrained as follows:

(a) Other than limited amounts permitted by Panhandle under limited circumstances for a limited period of time, CILCO was unable to purchase natural gas for resale in the relevant geographic market from any person or entity except Panhandle;

(b) CILCO was unable to compete with Panhandle in the wholesale purchase of natural gas directly from producers and others;

(c) Producers and others with natural gas for sale were unable to compete with Panhandle in the sale of gas to CILCO for resale;

(d) CILCO was unable to compete with the prices offered by Panhandle, producers and others for the sale of natural gas directly to end-users in the relevant geographic market;

(e) CILCO was unable to compete with the prices of alternative fuels available to some end-users in the relevant geographic market.

24. By reason of Panhandle's refusal to transport until end-users had complied with Panhandle's Transportation Guidelines, competition was stifled and trade was restrained as follows:

(a) CILCO, in its capacity as an end-user of natural gas, and other end-users were prevented from seeking lower prices from competitive sellers of gas after the initial prices had been submitted to and accepted by the suppliers designated by Panhandle;

(b) Delays were encountered in obtaining transportation of gas;

(c) Producers and other suppliers were effectively discouraged and deterred from offering natural gas for direct sale to end-users within the relevant geographic market because of the delays encountered while waiting to determine if a Panhandle-designated supplier would agree to make the sale;

(d) Transportation contracts were limited to six months, precluding longer-term arrangements without again going through the bid-out process.

INJURY TO CILCO

25. Panhandle's actions described in this Complaint have injured and damaged CILCO in the following ways:

(a) CILCO has been required to purchase natural gas from Panhandle at prices higher than CILCO would have paid for purchase of natural gas from others;

(b) End-users in the relevant geographic market who would have purchased natural gas from CILCO at retail instead purchased natural gas from others, including PanMark and Panhandle Trading Company, or ceased the use of natural gas altogether, thereby causing CILCO to lose the profit that would have been earned on such sales;

(c) End-users in the relevant geographic market who continued to purchase natural gas from CILCO at retail reduced the amounts of gas they otherwise would have purchased, thereby causing CILCO to lose profit that otherwise would have been earned;

(d) End-users in the relevant geographic market who purchased transportation from CILCO reduced the amount of such purchases, thereby causing CILCO to lose profit that otherwise would have been earned;

(e) In order to retain customers, CILCO was required to reduce its margin on sales of gas to certain end-users in the relevant geographic market, thereby reducing the profit that CILCO would have earned if CILCO had been able to purchase lower priced natural gas from suppliers other than PANHANDLE.

CLAIMS UNDER THE FEDERAL ANTITRUST LAWS

COUNT I – MONOPOLIZATION

26. CILCO realleges and incorporates the allegations of paragraphs 1 through 25.

27. Panhandle possesses monopoly power in the transportation and sale of natural gas within the relevant geographic market, as evidenced by the following:

(a) Panhandle owns and operates the only facility for delivery of natural gas to the Springfield submarket;

(b) Until November of 1985, PANHANDLE's interstate pipeline was the only facility for delivery of natural gas to the Peoria-Pekin submarket, and from November of 1985 until October of 1986, was the only facility with FERC authority to transport natural gas to the Peoria-Pekin submarket except in cases of emergency;

(c) From October of 1986 until after February 20, 1987, PANHANDLE was able to preclude CILCO from transporting natural gas for resale to end-users in the Peoria-Pekin submarket by threatening to transfer CILCO to PANHANDLE's Limited Service rate;

(d) PANHANDLE has been able to maintain a market share of 100% for the transportation of gas to the Springfield submarket, and a market share of 100% for the transportation of gas to the Peoria-Pekin submarket until October of 1986, and thereafter a market share of approximately 85% until February 20, 1987;

(e) PANHANDLE has been able to maintain a market share of approximately 70% or higher for the sale of gas to the relevant geographic market until February 20, 1987;

(f) PANHANDLE has been able to require end-users to comply with PANHANDLE's Transportation

Guidelines in order to purchase and transport gas for end-users within the relevant geographic market;

(g) Panhandle has the power to exclude potential competitors from the relevant market;

(h) Panhandle has actually excluded potential competitors from the relevant market;

(i) Panhandle has the power to control prices in the relevant market, as evidenced by Panhandle's purchase of gas from an affiliated company at prices above the market and PANHANDLE's ability to require distributors to accept and pay for such higher-priced gas.

28. Panhandle has willfully acquired or maintained monopoly power over the transportation and sale of natural gas within the relevant geographic market through the following exclusionary practices:

(a) Panhandle has unreasonably refused to grant actual and potential competitors access to its pipeline system serving the relevant market, when access to such system is essential for effective competition with Panhandle within the relevant market;

(b) To prevent competitors from gaining access to the relevant market, Panhandle has filed sham objections before the Federal Energy Regulatory Commission, and has otherwise attempted to control or limit the use of an interconnection between CILCO and a different interstate pipeline having potential access to the Peoria-Pekin submarket;

(c) Panhandle has maintained and utilized an anti-competitive provision in its tariff to prevent competitors from gaining access to the relevant market;

(d) The availability of Panhandle's interstate pipeline system for transporting natural gas into the relevant market has been directly or indirectly tied by Panhandle to the purchase of natural gas from or through Panhandle;

(e) Panhandle has imposed Transportation Guidelines upon persons and entities seeking to purchase and transport gas into the relevant geographic market, thereby substantially delaying or inhibiting the ability of such persons and entities to secure natural gas from sources other than Panhandle;

(f) Panhandle has otherwise exploited unfairly its dominant position within the relevant market so as to perpetuate and further entrench its monopoly power within such market.

29. The conduct of Panhandle described in paragraphs 26 through 28 constitutes actual monopolization in violation of Section 2 of the Sherman Act, 15 U.S.C. §2, and plaintiff has been injured in its business or property by reason of said violation.

COUNT II – ATTEMPTED MONOPOLIZATION

30. Plaintiff realleges and incorporates the allegations of paragraphs 1 through 25.

31. Panhandle has engaged in the exclusionary practices alleged in paragraph 28 with the specific intent to acquire monopoly power within the relevant market.

32. Such exclusionary practices constitute predatory or anticompetitive acts engaged in to further Panhandle's purpose to monopolize the relevant market.

33. A dangerous probability exists of Panhandle successfully acquiring or maintaining monopoly power within the relevant market, as evidenced by such factors as its dominant market share within the relevant market; its actual exclusion and inhibition of actual or potential competitors; its use of an anticompetitive tariff to exclude competitors; its ability to force distributors to purchase gas at prices above the market; and its control of the only pipeline system serving the relevant market.

34. The conduct of Panhandle described in paragraphs 30 through 33 constitutes an attempt to monopolize in violation of Section 2 of the Sherman Act, 15 U.S.C. §2, and

plaintiff has been injured in its business or property by reason of said violation.

COUNT III – MONOPOLY LEVERAGING

35. Plaintiff realleges and incorporates the allegations of paragraphs 1 through 25.

36. Panhandle's ownership and control of the only pipeline system serving the relevant market gave it monopoly power over the transportation of natural gas into the relevant market, and continue to give it monopoly power over the transportation of natural gas to the Springfield submarket.

37. The transportation of natural gas through the Panhandle pipeline system serving the relevant market constitutes a product market separate and distinct from the sale of natural gas transported through such system.

38. Panhandle has exploited its monopoly power over such natural gas transportation to exact unwarranted competitive advantages in the sale of natural gas within the relevant market, by denying competing sellers of natural gas equal access to such pipeline system, by imposing "Transportation Guidelines" significantly inhibiting the ability of competing sellers to compete for natural gas within the relevant market, and through other practices designed to unfairly exploit its monopoly power over natural gas transportation to exact competitive advantages in natural gas sales.

39. The conduct of Panhandle described in paragraphs 35 through 38 constitues monopoly leveraging in violation of Section 2 of the Sherman Act, 15 U.S.C. §2, and plaintiff has been injured in its business or property by reason of such violation.

COUNT IV – ESSENTIAL FACILITY

40. Plaintiff realleges and incorporates the allegations of paragraphs 1 through 25.

41. As hereinabove set forth, Panhandle possessed monopoly power over the transportation and sale of natural gas to the relevant geographic market, and continues to possess such power with respect to the Springfield submarket.

42. Panhandle's pipeline system was at all times relevant hereto and still is the only interstate pipeline with access to the Springfield submarket for natural gas, and was until October of 1986, the only interstate pipeline reasonably available for access to the Peoria-Pekin submarket for natural gas. As the sole access to the two submarkets, Panhandle's pipeline was an essential facility for effective competition within the relevant market.

43. The essential facility could not practically or reasonably be duplicated by actual or potential competitors desiring to transport natural gas into the relevant market.

44. Panhandle has denied and continues to deny use of such essential facility to actual or potential competitors, when it was, and is, feasible for Panhandle to grant such use.

45. The conduct of Panhandle described in paragraphs 40 through 44 constitutes misuse of an essential facility in violation of Section 2 of the Sherman Act, 15 U.S.C. §2, and plaintiff has been injured in its business or property by reason of such violation.

COUNT V – ILLEGAL TYING

46. Plaintiff repeats and realleges the allegations of paragraphs 1 through 25.

47. The transportation of natural gas over pipeline systems is a product separate and distinct from the sale of natural gas transported over such systems.

48. Panhandle holds sufficient economic power respecting the transportation of natural gas into the relevant market to enable it to raise prices of transportation or require users of such service to accept burdensome terms that could not be exacted in a completely competitive market.

49. Panhandle has directly or indirectly conditioned the availability of its pipeline system for transporting natural gas into the relevant geographic market upon the purchase of natural gas from Panhandle.

50. As a result of such direct or indirect conditioning by Panhandle, a substantial amount of commerce in the sale of natural gas into and within the geographic market has been affected.

51. The conduct of Panhandle described in paragraphs 46 through 50 constitutes a tying practice in violation of Section 1 of the Sherman Act, 15 U.S.C. §1, and plaintiff has been injured in its business or property by reason of said violation.

CLAIMS UNDER THE ILLINOIS ANTITRUST ACT

COUNT VI – ACTUAL MONOPOLIZATION

52. Plaintiff realleges and incorporates the allegations of paragraphs 1 through 25.

53. The transportation and sale of natural gas to the relevant geographic market comprise a substantial part of the trade or commerce of the State of Illinois.

54. Panhandle has willfully engaged in the exclusionary practices alleged in paragraph 28 to establish, maintain or use its monopoly power over transportation and sale of natural gas to the relevant geographic market for the purpose of excluding competition or of controlling, fixing, or maintaining prices in such trade or commerce.

55. The conduct of Panhandle alleged in paragraphs 52 through 54 constitutes actual monopolization in violation of Section 3 of the Illinois Antitrust Act, ¶60-3(3), Chap. 38, Ill. Rev. Stat. (1982), and plaintiff has been injured in its business or property by reason of said violation.

COUNT VII – ATTEMPTED MONOPOLIZATION

56. Plaintiff realleges and incorporates the allegations of paragraphs 1 through 25.

57. The transportation and sale of natural gas to the relevant geographic market comprise a substantial part of the trade or commerce of the State of Illinois.

58. Panhandle has willfully engaged in the exclusionary practices alleged in paragraphs 28 in an attempt to acquire monopoly power over the transportation and sale of natural gas to the relevant geographic market for the purpose of excluding competition or of controlling, fixing or maintaining prices in such trade or commerce.

59. The conduct of Panhandle described in paragraphs 56 through 58 constitutes attempted monopolization in violation of Section 3 of the Illinois Antitrust Act, ¶60-3(3), Chap. 38, Ill. Rev. Stat. (1982), and plaintiff has been injured in its business or property by reason of said violation.

COUNT VIII – MONOPOLY LEVERAGING

60. Plaintiff realleges and incorporates the allegations of paragraphs 1 through 25.

61. The transportation and sale of natural gas to the relevant geographic market comprise a substantial part of the trade or commerce of the State of Illinois.

62. Panhandle has willfully engaged in the exclusionary practices alleged in paragraph 38 to establish, maintain, use or attempt to acquire monopoly power over the sale of natural gas to the relevant geographic market for the purpose of excluding competition or of controlling, fixing or maintaining prices in such trade or commerce.

63. The conduct of Panhandle described in paragraphs 60 through 62 constitutes monopoly leveraging in violation of Section 3 of the Illinois Antitrust Act, ¶60-3(3), Chap. 38, Ill. Rev. Stat. (1982), and plaintiff has been injured in its business or property by reason of said violation.

COUNT IX – ESSENTIAL FACILITY

64. Plaintiff realleges and incorporates the allegations of paragraphs 1 through 25.

65. The transportation and sale of natural gas to the relevant geographic market comprise a substantial part of the trade or commerce of the State of Illinois.

66. Panhandle has engaged in the exclusionary practices alleged in paragraph 44 to establish, maintain, use or attempt to acquire monopoly power over the transportation and sale of natural gas to the relevant geographic market for the purpose of excluding competition or of controlling, fixing or maintaining prices in such trade or commerce.

67. The conduct of Panhandle described in paragraphs 64 through 66 constitutes misuse of an essential facility in violation of Section 3 of the Illinois Antitrust Act, ¶60-3(3), Chap. 38, Ill. Rev. Stat. (1982), and plaintiff has been injured in its business or property by reason of said violation.

COUNT X – ILLEGAL TYING

68. Plaintiff repeats and realleges the allegations of paragraphs 1 through 25.

69. The transportation and sale of natural gas to the relevant geographic market comprise a substantial part of the trade or commerce of the State of Illinois.

70. Panhandle has directly or indirectly conditioned the availability of its pipeline system for transporting natural gas to the relevant geographic market upon the purchase of natural gas from Panhandle, and the effect of such exclusionary practice may be to substantially lessen competition or tend to create a monopoly in the transportation or sale of natural gas to the relevant geographic market.

71. The conduct of Panhandle described in paragraphs 68 through 70 constitutes a tying practice in violation of Section 3 of the Illinois Antitrust Act, ¶60-3(4), Chap. 38, Ill. Rev. Stat. (1982), and plaintiff has been injured in its business or property by reason of said violation.

NECESSITY FOR EQUITABLE RELIEF

72. Panhandle continues to own, operate and control the only interstate pipeline with access to the Springfield submarket and the only interstate pipeline with the capability of delivering natural gas from certain producers to the Peoria-Pekin submarket. The violations of law by Panhandle hereinabove set forth have caused plaintiff permanent and irreparable injury, and unless enjoined and restrained by order of this Court will be continued and will cause further irreparable injury and damage, for which plaintiff has no adequate remedy at law, in the following respects:

(a) CILCO will continue to pay higher prices for natural gas;

(b) CILCO will be unable to purchase natural gas directly from producers and other suppliers in certain areas of the United States from which CILCO would be able to purchase if PANHANDLE did not refuse to transport;

(c) Trade or commerce in the relevant market will continue to be restrained, existing end-users in the relevant geographic market will permanently shift their business activities outside the relevant geographic area or commit their facilities to the use of fuels other than natural gas, which other fuels CILCO cannot supply through its pipeline distribution system, and potential end-users in the relevant geographic market will elect instead to establish their facilities at locations outside the relevant geographic market.

RELIEF SOUGHT

WHEREFORE, CENTRAL ILLINOIS LIGHT COMPANY prays as follows:

A. That the Court adjudge and decree that PANHANDLE has violated and continues to violate Sections 1 and 2 of the Sherman Act and Section 3 of the Illinois Antitrust Act, that said violations be enjoined, and that PANHANDLE be ordered and directed to transport natural gas to the relevant geographic market for CILCO, on a nondiscriminatory basis.

B. That CILCO have judgment against PANHANDLE in the amount of the damages determined to have been sustained by CILCO, which damages are presently estimated to be in excess of $70,000,000, and that said damages be trebled as required by law.

C. That CILCO have judgment as provided by law for reasonable attorneys' fees and expenses in an amount to be determined by the Court.

D. That CILCO have judgment for its costs herein.

E. That CILCO have such other, further, separate and different relief as the Court may deem proper.

JURY DEMAND

Plaintiff, CENTRAL ILLINOIS LIGHT COMPANY, respectfully requests a trial by jury pursuant to Rule 38(B) of the Federal Rules of Civil Procedure.

CENTRAL ILLINOIS LIGHT COMPANY

By its attorneys

William L. Kasley
300 Liberty Street
Peoria, IL 61602
(309) 672-5009

/s/ WILLIAM L. KASLEY

Edward J. Griffin
Defrees & Fiske
72 West Adams Street
Chicago, IL 60603
(312) 372-4000

/s/ EDWARD J. GRIFFIN

John R. Schaefgen, Jr.
Reid & Priest
1111 19th Street N.W.
Washington, D.C. 20036
(202) 828-0100

/s/ JOHN R. SCHAEFGEN, JR.

Attorneys for Plaintiff
Central Illinois Light Company

GAS SALES CONTRACT

(For Use Under General Service Rate Schedules)

THIS CONTRACT, entered into as of the 14th day of May 1984, by and between PANHANDLE EASTERN PIPE-LINE COMPANY, a Delaware corporation (hereinafter called Seller) and CENTRAL ILLINOIS LIGHT COMPANY an Illinois corporation (hereinafter called buyer), witnesses that in consideration of the mutual covenants and promises as herein set forth, the parties hereto covenant and contract as follows:

ARTICLE 1—GAS TO BE SOLD AND PURCHASED

Seller agrees to sell and deliver, and Buyer agrees to purchase and receive, the following volumes of natural gas, which shall constitute the Contract Demands for the respective months:

During month of	Mcf of Contract Demand
January, February, March, November, December	276,300
April	200,700
May	148,410
June	97,830
July	94,320
August	94,320
September	127,890
October	185,490

ARTICLE 2—RATE SCHEDULE

For all natural gas delivered by Seller to Buyer under the terms hereof, Buyer agrees to pay Seller the prices provided for under Seller's Rate Schedule G-2 as filed with the Federal Energy Regulatory Commission, and as same may hereafter be legally amended or superseded.

Deliveries hereunder shall be subject to the provisions of such Rate Schedule and the General Terms and Conditions applicable thereto on file with the Federal Energy Regulatory Commission (as same may be hereafter be legally amended or superseded), which by reference are incorporated herein and made a part hereof.

ARTICLE 3—BUYERS SERVICE AREA AND STORAGE FACILITIES

The service area(s) and storage facilities of Buyer, for which the natural gas purchased hereunder is intended for resale to ultimate consumers, is (are) as follows:

A) Peoria and Springfield Delivery point including the cities and villages of Bartonville, Bellevue, Chatham, Creve Coeur, East Peoria, Eden, Elmwood, Farmington, Grand View, Hanna City, Jerome, Marquette Heights, North Pekin, Pekin, Peoria, Peoria Heights, Rochester, Southern View, Springfield, Trivoli, Washington, Williamsville, Yates City, and the surrounding areas served from Buyer's distribution system.

B) Lincoln and Tuscola delivery points including the cities and villages of Arthur, Atwood, Camargo, Catlin, Chrisman, Delavan, Garret, Hammond, Hume, Lincoln, Metcalf, Mt. Pulaski, Murdock, Newman, Pesotum, Pierson Station, San Jose, Scottland, Tolono, Tuscola, Villa Grove and environs.

ARTICLE 4—POINTS OF DELIVERY

Delivery of the natural gas by Seller to Buyer shall be at or near Point of Delivery indicated below and Seller shall not be obligated to deliver gas in greater daily volume and at a pressure in excess of that specified with respect to each Point of Delivery:

Point of Delivery	Maximum Daily Delivery Obligation (MCF)	Delivery Pressure (P.S.I.G.)

See Next Page

ARTICLE 4—POINTS OF DELIVERY

Delivery of the natural gas by Seller to Buyer shall be at or near the Point of Delivery indicated below and Seller shall not be obligated to deliver gas in greater volume and at a pressure in excess of that specified with respect to each Point of Delivery:

Point of Delivery	Maximum Daily Delivery Obligation (MCF)	Delivery Pressure (P.S.I.G.)
Peoria Delivery Points	190,500*	350
Springfield Delivery Points	114,200*	250
Lincoln	18,600*	100
San Jose	5,500*	300
Delavan	2,300*	100
Mt. Pulaski	2,800*	350
Arthur	2,500	125
Atwood	1,600	100
Camargo	250	100
Catlin	1,600	100
Chrisman	1,700	125
Garrett	200	100
Hammond	500	100
Hume	500	100
Metcalf	2,300	300
Murdock	200	100
Newman	1,400	125
Pesotum	500	100
Pierson Station	250	100
Scottland	200	100
Tolono	1,700	200
Tuscola	5,000	200
Villa Grove	2,400	100

* NOTES: At no time shall the aggregate volumes delivered on a single day to these delivery points on the Peoria Lateral exceed 270,000 Mcf or the current contract demand, whichever is lesser.

ARTICLE 5—TERM

The term of this agreement shall commence on April 1, 1984, and shall continue in effect until December 31, 1989. This agreement shall continue thereafter for successive twelve (12) month periods, unless and until cancelled by either party on eighteen (18) months' written notice to the other, which notice may be made effective on December 31, 1989, or at the end of any succeeding twelve (12) month period.

ARTICLE 6—CANCELLATION OF PREVIOUS CONTRACTS

This agreement supersedes, cancels and terminates, as of the effective date hereof, the following contracts with respect to the sale of natural gas by Seller to Buyer.

Agreement between Seller and Buyer dated December 21, 1970.

ARTICLE 7—NOTICES

Except as herein otherwise provided, any notice, request, demand, statement or bill provided for in the General Terms and Conditions and the rate schedules to which they apply, or any notice which either Seller or Buyer may desire to give to the other, shall be in writing and shall be considered as duly delivered when mailed by registered mail to the Post Office address of Seller or Buyer, or at such other address as either shall designate by formal written notice. Routine communications, including monthly statements and payments, shall be considered as duly delivered when mailed by either registered or ordinary mail. The Post Office addresses of the parties hereto are as follows:

Panhandle Eastern Pipe Line Company
P.O. Box 1348
Kansas City, Missouri 64141
(Seller)

CENTRAL ILLINOIS LIGHT COMPANY
300 Liberty Street
Peoria, Illinois 61602
(Buyer)

ARTICLE 8—SUCCESSION AND ASSIGNMENT

This agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

IN WITNESS WHEREOF, the parties hereto have caused their authorized officers to execute this agreement as of the date hereinabove written.

PANHANDLE EASTERN PIPE LINE COMPANY
(Seller)

By /s/ R.L. LANGENKAMP
Vice President

(Corporate Seal)
ATTEST:

/s/ E.B. DAWSON
Assistant Secretary

CENTRAL ILLINOIS LIGHT COMPANY
(Buyer)

By /s/ W.R. VOGELSANG
President

(Corporate Seal)
ATTEST:

/s/ M. MURRAY
Secretary

APPENDIX G

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF ILLINOIS
PEORIA DIVISION

STATE OF ILLINOIS, *ex rel.* NEIL F. HARTIGAN, Attorney General of the State of Illinois, in its proprietary capacity, in its *parens patriae* capacity and in its representative capacity,

Plaintiff,

v.

PANHANDLE EASTERN PIPE LINE COMPANY, a Delaware corporation,

Defendant.

No. 84-1048
Honorable
Michael M. Mihm

THIRD AMENDED COMPLAINT

Plaintiff complains of defendant for violations of the antitrust laws of the United States and the State of Illinois as follows:

JURISDICTION AND VENUE

1. This Complaint is brought under Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§1, 2; 15 U.S.C. §§15, 15c, 26; 28 U.S.C. §1337 and the principles of pendent jurisdiction.

2. Venue properly rests in the Central District of Illinois pursuant to 15 U.S.C. §22 and 28 U.S.C. §1391(c).

PARTIES

3. Plaintiff brings this action in its proprietary capacity as both a direct and indirect purchaser of natural gas.

4. Plaintiff also brings this action as *parens patriae* on behalf of natural persons residing in Illinois damaged by the conduct alleged herein and to prevent the threatened loss and damage to the general economy of the State of Illinois.

5. Defendant Panhandle Eastern Pipeline Company ("Panhandle") is and was at all relevant times a corporation duly organized and existing under the laws of the State of Delaware, having offices and its principal place of business in Kansas City, Missouri. Panhandle is engaged in the interstate business of purchasing, gathering and selling natural gas and operating a pipeline system for the purpose of transporting natural gas. Panhandle does business in the Central District of Illinois, and owns, operates and controls the only pipeline system in the relevant geographic market, and thus has a transportation monopoly.

6. Panhandle's actions alleged herein were authorized, ordered and done by officers, agents or employees of Panhandle.

CLASS ALLEGATIONS

7. Plaintiff brings this action on its own behalf as an indirect purchaser of natural gas from Panhandle and also as a class action on behalf of all indirect purchasers of natural gas from Panhandle in Illinois, including natural persons, corporations, partnerships and associations of persons, damaged by the conduct alleged herein.

8. The class represented by Plaintiff consists of several thousands of indirect persons and is so numerous that joinder of all its members before the Court is impracticable.

9. The claims of the representative party are typical of the claims of the class. Common questions of law and fact raised by this Complaint affect all members of the class and predominate over any individual issues. Common relief is sought on behalf of all members of the class. This class action is superior to other available methods for the fair and efficient adjudication of this controversy.

10. The prosecution of separate actions by individual members of the class would create a risk of inconsistent or varying adjudications with respect to individual members of the class and a risk that any adjudications with respect to individual members of the class would, as a practical matter, either be dispositive of the interests of other members of the class not party to the adjudication or substantially impair or impede their ability to protect their interests.

11. Plaintiff will fairly and adequately protect and represent the interests of the class. The management of the class action proposed is not difficult and, moreover, the factual and legal issues raised by this Complaint will not require extended contact with the members of the class since the conduct engaged in by Panhandle was perpetrated on all class members and will be established by common proof.

[remainder of Complaint omitted]

Supreme Court, U.S.
FILED
NOV 12 1988
JOSEPH F. SPANIOL, JR.
CLERK

(3)

No. 88-658

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

v.

STATE OF ILLINOIS, ex rel. NEIL F. HARTIGAN, Attorney General of the State of Illinois,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

RESPONDENT'S BRIEF IN OPPOSITION

Of Counsel:

NEIL F. HARTIGAN
Attorney General of the
State of Illinois
100 West Randolph Street
12th Floor
Chicago, Illinois 60601

EDWARD J. BURKE
RAYMOND J. SMITH *
MARY PATRICIA BURNS
Special Assistant Attorneys
General
BURKE AND SMITH CHARTERED
55 West Monroe Street
Suite 1800
Chicago, Illinois 60603
(312) 853-3230

* (Counsel of Record)

Attorneys for Respondent

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

19 pp

QUESTIONS PRESENTED

Petitioner's statement of "Questions Presented" violates the dictate of Supreme Court Rule 21.1(a) that questions should be expressed in the terms and circumstances of the case. No portion of the Seventh Circuit's *en banc* opinion can be construed as overruling the Court's holding in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977). To the contrary, the Seventh Circuit embraced the decision and in applying it concluded that the unique factual and legal relationship between a publicly regulated natural gas local distribution company and its captive residential customers constituted a cost-plus contract within the meaning of the exception to the *Illinois Brick* rule.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

v.

STATE OF ILLINOIS, ex rel. NEIL F. HARTIGAN, Attorney General of the State of Illinois,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

RESPONDENT'S BRIEF IN OPPOSITION

Respondent State of Illinois respectfully requests that the Court deny the petition for writ of certiorari seeking review of the United States Court of Appeals for the Seventh Circuit's *en banc* opinion in this case.

OPINIONS BELOW

Subsequent to its ruling on July 18, 1988, but prior to publication, the Seventh Circuit corrected a misstatement in its *en banc* opinion. Petitioner's appendix at page A-1

does not set forth the corrected opinion. Accordingly, a copy of the Seventh Circuit's officially reported decision, at 852 F.2d 891 (7th Cir. 1988), is printed in Respondent's appendix at page R.App. 1; the correction appears at R. App. 12.[1]

STATEMENT OF THE CASE

In February, 1984, the State of Illinois ("State") filed the instant action against Panhandle Eastern Pipe Line Company ("Panhandle") alleging violations of Sections 1 and 2 of the Sherman Act.[2] 15 U.S.C. §§1, 2. The State sued both in its sovereign *parens patriae* capacity, and in its proprietary capacity as a gas consumer. Acting in this proprietary capacity the State also has been certified to represent a class of gas consumers residing in the geographic area of central Illinois served exclusively by Panhandle.

Panhandle owns and controls the only interstate pipeline that transports natural gas through Central Illinois Light Company ("CILCO") to the gas consumers within CILCO's service area. Panhandle, like most major interstate pipelines, is vertically integrated, owning extensive exploration, development and production affiliates. Panhandle sells

[1] "R.App." references are to the Respondent's Appendix.

[2] The State in its complaint alleges, *inter alia*, that Panhandle's conduct constituted an illegal (1) use of its essential facility; (2) tying of access to its transportation service to the purchase of its natural gas; and (3) monopoly leveraging of its power over transportation to obtain and maintain a monopoly over the sale of natural gas in the central Illinois market.

its own gas as well as gas it contracts for from other producers to CILCO's consumers. The complaint alleges that during the relevant time period abundant supplies of gas not under contract to Panhandle were available to gas consumers in central Illinois at a price substantially below that of Panhandle. The State's claims are based on Panhandle's refusal to transport any gas into the area except its own supracompetitively priced gas. As a result, Panhandle extracted from CILCO's customers well over 50 million dollars in anticompetitive overcharges.

The Relationship Between CILCO, A Natural Gas Local Distribution Company, And Its Residential Customers

CILCO is a publicly regulated retail distributor of natural gas. CILCO's service area covers sections of fourteen counties in central Illinois. It is a non-integrated pipeline in that it owns lines that are not connected to each other. Its main line, however, services 98 percent of its customers. The area covered by CILCO's main line is not served by any other natural gas local distribution company ("LDC"). CILCO's main line is connected to only one interstate pipeline, Panhandle.[3] Thus, as to the relevant portion of CILCO's service area the structure of natural gas distribution is simple: a single interstate pipeline, Panhandle, transports gas to the area and sells it to a single LDC, CILCO; CILCO then transports and resells the gas to its customers. CILCO, in short, is captive to Panhandle, and CILCO's customers are captive to it.

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[3] The remaining two percent of CILCO's customers, who are not within plaintiff's class, are served by interstate pipelines other than Panhandle.

CILCO is regulated by the Illinois Commerce Commission ("ICC"). In 1982, pursuant to the Illinois Public Utility Act, the ICC promulgated the Uniform Purchased Gas Adjustment Clause ("Uniform PGA") applicable to all LDCs subject to its jurisdiction. The Uniform PGA is a mathematical formula that requires LDCs, such as CILCO, to fully recover their gas costs from their customers. Under the Uniform PGA an LDC has absolutely no discretion and must pass through to its customers 100 percent of its cost of gas; an LDC may not absorb one cent of its cost of gas sold.

During the period January 1, 1983 to the present, CILCO's filed tariff has contained a Uniform PGA provision whereby CILCO passes its cost of gas purchased from Panhandle through to its customers dollar-for-dollar. Each month CILCO makes a Uniform PGA filing with the ICC which sets forth Panhandle's gas charge. That gas charge is then passed through to CILCO's customers in its entirety as a separate and distinct component of each customer's bill. CILCO, therefore, recovers its exact cost of gas regardless of whether Panhandle's gas price increases or decreases. CILCO complied at all times with the Uniform PGA.

CILCO divides its customers into residential, commercial and industrial categories by virtue of its rates and tariff classifications approved by the ICC. An example of the clear distinction CILCO draws between its customers is reflected in its application to the ICC for approval of Rate 7. In 1983, certain of CILCO's large fuel-switchable industrial customers had available to them supplies of alternate fuel at a price below the regulated price of CILCO's gas. In order to meet this competition CILCO applied for Rate 7 which was expressly limited to this particular classification of customers. Under Rate 7, CILCO

obtained specific ICC permission to reduce for a four-month period its profit margin approximately 2¢ per therm on revenues derived from its transmission service. The Rate 7 reduction amounted to $935,527.15. At no time did CILCO seek a similar rate reduction for its residential customers. Those customers, unlike CILCO's industrial customers, did not have alternatives to CILCO's gas.

Petitioner in its "Statement of the Case", as it has in its briefs to the courts below, lumps together CILCO's residential and industrial customers and attempts to give the impression that CILCO's sales decreases were due to decreases in residential sales. This is misleading. For instance, in 1984 when CILCO's overall sales decreased 2.3 percent, its sales to residential customers actually increased 13 percent. Further, there is no evidence to indicate whether any decline in CILCO's sales was caused by price rather than other factors such as demographics, unemployment and weather.

REASONS FOR DENYING THE WRIT

I.

THE SEVENTH CIRCUIT'S DECISION IS CONSISTENT WITH THE COURT'S DECISIONS IN *HANOVER SHOE* AND *ILLINOIS BRICK*.

This case presents an extremely narrow legal issue within an unusual and narrowly circumscribed factual context. The problem concerns a group of residential purchasers of natural gas in Illinois who are the captive customers of a state regulated distributor, CILCO, that is in turn the captive customer of Panhandle, an interstate seller

and distributor of natural gas. The claim that underlies this suit is that since 1983 Panhandle has been charging CILCO a supracompetitive price for its gas. By virtue of state regulation of distributors of natural gas and CILCO's monopoly power over residential consumers, CILCO, as the Seventh Circuit found, was able to and did pass on to its residential consumers 100 percent of the anticompetitive overcharge without sacrificing any profits (R.App. 13).

The Seventh Circuit held that under these circumstances the relationship between the residential consumers and CILCO is a cost-plus contract within the cost-plus exception to the *Illinois Brick* rule (R.App. 13-14). *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977). Petitioner asserts, however, that the Court in *Illinois Brick* directed that all cost-plus contracts must contain a fixed quantity term to be within the exception. Petitioner then argues that because such a term is absent here, the Court would decide that the damage claims of the residential consumers would be barred (Pet. at 11-14).[4] The Seventh Circuit analyzed both the rule and its exceptions, as well as the reasons that gave rise to those exceptions, and concluded that the Court's reference to a fixed quantity provision was not to require such a term as an independent element of a cost-plus contract, but was to explain that some factor was necessary in addition to an established price (*i.e.*, cost-plus) to ensure that the whole of the anticompetitive overcharge is passed through to the indirect purchaser without apportionment (R.App. 3-4, 12-13). The Seventh Circuit found that the factors present in this case provided that precise assurance (R.App. 13).

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[4] "Pet." refers to the petition for writ of certiorari filed by defendant Panhandle.

As the Seventh Circuit recognized, the central fact of the *Illinois Brick* rule is that the direct purchaser who resells anticompetitively priced goods in a competitive market is likely to make the subjective pricing decision to absorb a portion of the overcharge in order to hold its customers. Where this occurs, the antitrust plaintiff—whether it be the direct or indirect purchaser—must reconstruct that subjective decision in order to trace the portion of the anticompetitive overcharge it bore. In order to avoid imposing on antitrust plaintiffs the burden of reconstructing the apportionment decision and at the same time avoid the danger of duplicative recoveries, the Court in *Illinois Brick* considered itself compelled to select between the direct and indirect purchaser as the appropriate party to pursue the antitrust violator. The Court selected the direct purchaser and ruled that in such cases the indirect purchaser may not sue for antitrust damages. In the Court's view, this course best promoted effective enforcement of the antitrust laws. *Illinois Brick*, 431 U.S. at 732-735.

The Court acknowledged, however, that there could be circumstances where the direct purchaser would not make the pricing decision to absorb some or all of the overcharge in order to hold its customers. In such circumstances, the reasons for the *Illinois Brick* rule are inoperative and indirect purchasers are not precluded from pursuing the antitrust violator. One general circumstance noted by the Court is where there is a cost-plus contract between the direct and indirect purchaser. *Illinois Brick*, 431 U.S. at 736. The Seventh Circuit held that the automatic fuel pass-through provision (the Uniform PGA) is such a cost-plus contract (R.App. 13-14).

Nevertheless, as the Court observed in *Illinois Brick*, even the direct purchaser armed with a cost-plus contract

might feel constrained to absorb a portion of the overcharge. This could occur where the direct purchaser's customers had alternative suppliers and could choose to decrease the volume of their purchases from it to avoid the anticompetitive overcharge. *Illinois Brick*, 431 U.S. at 736. This would *not* occur where the price term between the direct and indirect purchaser is regulated and where the indirect purchaser has no alternative to purchasing its entire supply from the direct purchaser (R. App. 7-9).

Thus, where the direct purchaser sets its price in a competitive, unregulated market, a fixed quantity term in a cost-plus contract fully relieves it of the necessity of deciding whether to absorb any of the anticompetitive overcharge; and in the absence of such a term, the basic *Illinois Brick* rule is applicable. *See, Mid-West Paper Products Co. v. Continental Group, Inc.*, 596 F.2d 573, 577 n.9 (3rd Cir. 1979). But here, CILCO's prices are the product of the particular Illinois laws that apply to distributors of natural gas and CILCO's monopoly power over its captive residential consumers. The Seventh Circuit considered these two factors—the presence of public utility regulation and the absence of competition—a "stand-in" for a quantity term present in the normal, privately negotiated contract (R.App. 8). CILCO could force the whole of the overcharge through to its residential consumers, and it did so (R.App. 7-9, 13). Accordingly, the Seventh Circuit held that the Court, applying *Illinois Brick*, would have selected the class of residential consumers as the appropriate party to sue for the damages they suffered as a result of Panhandle's misconduct (R.App. 14).

Petitioner argues that the Court's opinion in *Illinois Brick* prohibits a factual analysis, especially from an eco-

nomic perspective, as to whether a cost-plus contract exists (Pet. at 8-9). To the contrary, the Court's decision in *Illinois Brick* necessitates a factual analysis to determine whether it is " 'easy to prove that [the direct purchaser] has not been damaged;' " or in other words "that the overcharge has not been absorbed by the direct purchaser." *Illinois Brick*, 431 U.S. at 732, n.12, *quoting*, *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481, 494 (1968). In conducting this exact type of factual analysis, the Seventh Circuit did not rely on "simplifying economic assumptions," (Pet. at 14), but rather on facts easily determinable in the real economic world to conclude that: ". . . for every cubic foot of gas bought by a residential customer, we *know* that the whole overcharge was passed on to the consumers in accordance with the fuel pass-through provision of their contract with CILCO, and we know why (regulation plus the residential consumers' lack of alternatives)" (R.App. 13). As to these consumers, there was no absorption of the overcharge by CILCO. Contrary to petitioner's claim that *Illinois Brick* forbids *any* examination of the facts, what the Court sought to avoid was the use of hypothetical economic models, in cases where apportionment had occurred, to determine the extent of that apportionment. *See, Blue Shield of Virginia v. McCready*, 457 U.S. 465, 475, n.11 (1982).

Furthermore, as the Seventh Circuit found, because there was no apportionment of the overcharge, there is no danger of duplicative recovery (R.App. 9-11). The fact that CILCO filed suit against petitioner three years after the State's action was filed, over one month after completion of the State's 13-week trial on liability, and at a time when the statute of limitations had run or was about to run against CILCO, does not alter the conclusion. Un-

der the Seventh Circuit's rationale, as well as the symmetry and fairness principles articulated in *Illinois Brick*, because the CILCO-residential consumer relationship is within the cost-plus exception, petitioner will be able to successfully assert a *Hanover Shoe* pass-on defense against CILCO barring CILCO from pursuing any claim for the same overcharge.[5] *Illinois Brick*, 431 U.S. at 728-729.

If CILCO decides to pursue its action against petitioner, it will be able to seek damages for its alleged lost sales, but again the specter of duplicative recovery does not arise. The residential consumers are seeking, and have been allowed to sue solely for, the overcharge embedded in the *sales made*. Only CILCO can sue for its lost profits on the *sales allegedly not made* (R.App. 9-10). The damage to the residential consumers is distinct and in no way overlaps with the damage to CILCO (R.App. 10). *Accord, In re Beef Industry Antitrust Litigation*, 600 F.2d 1148, 1164 (5th Cir. 1979), *cert. denied*, 449 U.S. 905 (1980), ("The middleman's loss of volume and the indirect purchaser's absorption of the overcharge are wholly separable items of damage."). Accordingly, as the Seventh Circuit found, while there may be more than one set of plaintiffs, each set will be suing in respect of different sales—not, as in *Illinois Brick*, the same sales (R.App. 10).

In sum, the Seventh Circuit's decision is not in conflict with *Illinois Brick* or *Hanover Shoe*; it does not overrule *Illinois Brick*, create a new exception to *Illinois Brick*, or expand the cost-plus exception recognized in *Illi-*

[5] By agreement of CILCO and Panhandle, Panhandle has not been required to answer CILCO's complaint, thereby avoiding the obvious conflict that would result between the position it advocates here and its assertion of the *Hanover Shoe* pass-on defense in that case.

nois Brick. The Seventh Circuit scrutinized the unique legal and factual relationship between CILCO and its captive residential customers and concluded that this particular relationship was a cost-plus contract within the exception to the *Illinois Brick* rule. The narrow scope of the Seventh Circuit's decision does not encompass every regulated industry; only the natural gas industry with the specific pricing regulation that mandates the pass-on of the overcharge. Nor does the decision embrace every natural gas consumer; only those who have no alternatives to the direct purchaser's gas.

For the reasons set forth above, the petition for a writ of certiorari should be denied.

II.

THE SEVENTH CIRCUIT'S DECISION IS NOT IN CONFLICT WITH THE CIRCUIT CASES THAT HAVE APPLIED *ILLINOIS BRICK*.

Petitioner attempts to mislead the Court when it states that the Seventh Circuit "concedes" that a conflict exists between its decision and the Third, Eighth and Ninth Circuits' cases which petitioner claims held that the cost-plus exception requires a fixed quantity provision (Pet. at 14-15), *See, Mid-West Paper Products Co. v. Continental Group, Inc.*, 596 F.2d 573, 577 n.9 (3rd Cir. 1979); *In re Midwest Milk Monopolization Litigation*, 730 F.2d 528, 533 (8th Cir.), *cert. denied*, 469 U.S. 924 (1984); *Arizona v. Shamrock Foods Co.*, 729 F.2d 1208, 1212, n.2 (9th Cir. 1984), *cert. denied*, 469 U.S. 1197 (1985).[6] The Seventh Cir-

[6] The only decision cited by petitioner, in actual conflict with the *en banc* court's decision is the district court's decision in *In re Wyoming Tight Sands Antitrust Litigation*, 1988-2 Trade Cas.

(Footnote continued on following page)

cuit made no such concession. The court had before it a "stand-in for the quantity requirement in an ordinary contract" and, therefore, expressly stated that it did *not* need to address the question of whether other cost-plus contracts, where such a term or stand-in was not present, were within the exception (R.App. 8, 14). In addition, the court distinguished the Third, Eighth and Ninth Circuits' cases on their facts, noting that each involved privately negotiated cost-plus contracts, whereas the CILCO-residential consumer relationship was governed by cost-plus contractual provisions required by state public utility regulation (R.App. 3).

Equally without merit is petitioner's claim that the Fifth Circuit's adoption of the "functional equivalent" approach, in contrast with the rejection of such an approach by other circuits, warrants review in this case (Pet. at 16-17). Even assuming that a conflict among the circuits exists, granting review in this case does not provide the Court with an opportunity to review that alleged conflict. The Seventh Circuit neither adopted nor rejected the functional equivalent approach, but stated explicitly that its decision was not dependent on such an analysis (R.App. 4-5). The Seventh Circuit did not need to rely on an "equivalent" because it found under these facts "the real McCoy"—a cost-plus contract (R.App. 5).

In seeking certiorari, petitioner also asserts that there is a conflict between the Seventh Circuit's decision and the Sixth Circuit's decision in *Jewish Hospital Ass'n v.*

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[6] *continued*

(CCH) ¶68,164 (D. Kan.), *appeal docketed*, Nos. 88-8042, 88-8043 (10th Cir. 1988), where the district court, relying on the now vacated panel decision in this case, held that *Illinois Brick* barred a suit by residential consumers of natural gas.

Stewart Mechanical Enterprises, Inc., 628 F.2d 971 (6th Cir. 1980), *cert. denied*, 450 U.S. 966 (1981), with respect to the "pre-existence requirement" (Pet. at 18). Petitioner for the first time cites *Jewish Hospital* for the proposition that the relationship between CILCO and its residential consumers lacks the "pre-existing relationship that insures in advance that the whole overcharge will be passed through" (Pet. at 18). This specific issue of whether the cost-plus contract must be in existence prior to commission of the anticompetitive conduct was not briefed or argued to the Court of Appeals and as the Court has often admonished, such a newly presented legal argument is not an appropriate basis for granting certiorari. *See, e.g., Equal Employment Opportunity Commission v. Federal Labor Relations Authority*, 476 U.S. 19, 24 (1986); *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 147, n.2 (1970).

The impropriety of asserting the lack of the pre-existing factor aside, petitioner's argument is merely its fixed quantity argument relabeled. In any event, all of the factors relied on by the Seventh Circuit to conclude that the CILCO-residential consumer relationship was within the cost-plus exception were in place prior to the anticompetitive conduct at issue here; namely, public utility rate regulation, including the Uniform PGA; CILCO's status as a monopolist; and the residential consumers' lack of alternatives.

Finally, petitioner contends certiorari should be granted because of the conflict between the majority of the *en banc* court and the dissenters (Pet. at 18-19). If petitioner's contention is valid, it leads to the absurd conclusion that certiorari would be appropriate in every circuit opinion in which a dissent is filed.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

EDWARD J. BURKE
RAYMOND J. SMITH *
MARY PATRICIA BURNS
Special Assistant Attorneys General
BURKE AND SMITH CHARTERED
55 West Monroe Street
Suite 1800
Chicago, Illinois 60603
(312) 853-3230

Attorneys for Respondent

* (Counsel of Record)

Of Counsel:

NEIL F. HARTIGAN
Attorney General of the State of Illinois
100 West Randolph Street
12th Floor
Chicago, Illinois 60601

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Supreme Court, U.S.
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JOSEPH F. SPANIOL, JR.
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No. 88-658

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

v.

STATE OF ILLINOIS, ex rel. NEIL F. HARTIGAN, Attorney General of the State of Illinois,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

APPENDIX TO RESPONDENT'S BRIEF IN OPPOSITION

Of Counsel:

NEIL F. HARTIGAN
Attorney General of the
State of Illinois
100 West Randolph Street
12th Floor
Chicago, Illinois 60601

EDWARD J. BURKE
RAYMOND J. SMITH *
MARY PATRICIA BURNS
Special Assistant Attorneys General
BURKE AND SMITH CHARTERED
55 West Monroe Street
Suite 1800
Chicago, Illinois 60603
(312) 853-3230

* (Counsel of Record)

Attorneys for Respondent

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

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852 F.2d 891 (7th Cir. 1988)

STATE OF ILLINOIS ex rel. Neil F. HARTIGAN, Attorney General of the State of Illinois, in its proprietary capacity, in its *parens patriae* capacity, and in its representative capacity,

Plaintiff-Appellee,

v.

PANHANDLE EASTERN PIPE LINE COMPANY,

Defendant-Appellant.

No. 85-2601.

United States Court of Appeals,
Seventh Circuit.

Argued Feb. 28, 1986.

Decided Jan. 22, 1988.

Rehearing En Banc May 26, 1988.

Decided July 18, 1988.

* * * * *

Before BAUER, *Chief Judge*, CUMMINGS, CUDAHY, POSNER, COFFEY, FLAUM, RIPPLE, MANION, and KANNE, *Circuit Judges*, and FAIRCHILD, *Senior Circuit Judge*.*

POSNER, *Circuit Judge*. Central Illinois Light Company (CILCO) is a publicly regulated retail distributor of nat-

* Circuit Judges WOOD, JR. and EASTERBROOK did not participate in the consideration or decision of this case.

ural gas. It bought natural gas from Panhandle Eastern Pipe Line Company at prices allegedly inflated because of violations of the antitrust laws by Panhandle, and resold the gas to residential and industrial consumers. In its resales to residential consumers, CILCO passed on the entire overcharge in the form of higher rates. In 1984 the State of Illinois brought this federal antitrust suit on behalf of CILCO's customers against Panhandle—which moved to dismiss the suit as barred by the "indirect purchasers" rule of *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481, 88 S.Ct. 2224, 20 L.Ed.2d 1231 (1968), and *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 97 S.Ct. 2061, 52 L.Ed.2d 707 (1977). The district court denied the motion, but certified its order of dismissal for an immediate appeal under 28 U.S.C. § 1292(b) and we agreed to hear the appeal. A panel of this court reversed the district court and directed it to dismiss the complaint. 839 F.2d 1206 (7th Cir. 1988). The full court granted rehearing en banc to decide whether regulatory cost-plus pricing can ever be excepted from the rule that "indirect purchasers" (CILCO's customers are indirect purchasers from Panhandle, CILCO being the direct purchaser) are barred from obtaining antitrust damages from their indirect seller. While the appeal was pending in this court, the district judge conducted a 13-week trial on liability, but he has deferred making a decision until we decide the appeal.

In *Hanover Shoe* the Supreme Court held that it is not a defense to an antitrust damages action that a buyer forced to pay a higher price because of the seller's antitrust violation passed on the cost of the violation to the buyer's customers (the seller's indirect purchases) by raising his prices to them, unless the buyer had a cost-plus contract with these customers. *Illinois Brick* announced a corollary to *Hanover Shoe*: the indirect purchaser cannot sue to recover the part of the overcharge that the buyer passed on to him. The Court again recognized an exception for the cost-plus contract, noting that it insulates the direct purchaser from "any decrease in its sales as a result of attempting to pass on the overcharge, because

its customer is committed to buying a fixed quantity regardless of price." *Id.* at 736, 97 S.Ct. at 2069-70. Fastening on the words "fixed quantity," the panel majority in this case held that the cost-plus exception is never available when the indirect purchasers are free to vary the quantity they buy from direct purchaser. The question for decision today is whether the exception is as confined as the panel thought.

The panel's opinion was not the first to read the exception so narrowly. See *Mid-West Paper Products Co. v. Continental Group, Inc.*, 596 F.2d 573, 577 n. 9, 580 (3d Cir. 1979); *In re Midwest Milk Monopolization Litigation*, 730 F.2d 528, 533 (8th Cir. 1984); *Lefrak v Arabian American Oil Co.*, 487 F. Supp. 808, 819 (E.D.N.Y. 1980); cf. *Arizona v. Shamrock Foods Co.*, 729 F.2d 1208, 1212 n. 2 (9th Cir. 1984); but see *In re Uranium Antitrust Litigation*, 552 F. Supp. 518 (N.D. Ill. 1982). And its reading was followed in *In re Wyoming Tight Sands Antitrust Cases*, ____ F. Supp. ____, No. 85-2349-S (D. Kan. May 4, 1988). Yet it was not dictated by precedent. Not only had the prior cases all involved privately negotiated cost-plus contracts rather than cost-plus contractual provisions required by public utility regulation, but there was no reason to believe that the reference to "fixed quantity" in the Supreme Court's opinion in *Illinois Brick* was intended to govern cases so remote from the actual arrangements under scrutiny in that case. The case did not involve a fixed-quantity contract; indeed it did not involve a cost-plus contract, but merely an argument (which the Court rejected, see 431 U.S. at 744, 97 S. Ct. at 2074) that a buyer's practice of rule-of-thumb cost-plus pricing should be enough to allow his customers to sue the seller. Certainly there is no indication that by using the words "fixed quantity" the Supreme Court meant to address the issue of the status of regulatory cost-plus pricing. We do a disservice to the Court by wrenching its words out of context and giving them a talismanic significance; we make language a trap rather than a mode of communication. The Supreme Court has never adverted to the issue involved in the present case, and we must

consider that issue in relation to the rationale of *Illinois Brick* rather than to isolated phrases in the Court's opinion. If we are to play the language game to which Panhandle invites us, moreover, then we must consider isolated phrases in other Supreme Court opinions, notably the majority opinion in *Blue Shield of Virginia v. McCready*, 457 U.S. 465, 474-75, 102 S.Ct. 2540, 2545-46, 73 L.Ed.2d 149 (1982), where the concern behind *Hanover Shoe* and *Illinois Brick* is described as "the risk of duplicative recovery engendered by allowing every person along a chain of distribution to claim damages arising from a single transaction that violated the antitrust laws." There is, as we shall see, no such risk in this case, at least so far as the residential purchasers from CILCO are concerned; and it is only they who have in our view, a persuasive claim to be entitled to sue.

Although several district courts have rejected an exception for cost-plus rate regulation, see (besides *Tight Sands*) *Go-Tane Service Stations, Inc. v. Ashland Oil, Inc.*, 508 F. Supp. 200, 204 (N.D. Ill. 1981); *City of Cleveland v. Cleveland Electric, Illuminating Co.*, 538 F. Supp. 1320, 1323-27 (N.D. Ohio 1980); *U.S. Oil Co. v. Koch Refining Co.*, 518 F. Supp. 957, 962-63 (E.D. Wis. 1981), the cases are distinguishable; and in the case with facts most like those of the present case the court held that indirect purchasers could sue because public utility regulation had created "a straight cost passthrough." *In re New Mexico Natural Gas Antitrust Litigation*, 1982-1 Trade Cases ¶ 64,685, at p. 73,722 (D.N. Mex. 1982). [available on WESTLAW, 1982 WL 1827] Cf. *County of Oakland v. City of Detroit*, 628 F. Supp. 610, 613 (E.D. Mich. 1986); *Illinois v. Borg, Inc.*, 548 F. Supp. 972, 975-76 (N.D. Ill. 1982). An additional wrinkle in the *New Mexico Natural Gas* case, however, was that the direct purchasers were in cahoots with the defendants; this was an independent ground for allowing the indirect purchasers to sue.

It is possible to allow indirect purchasers to sue in a case such as the present one without embracing the ill-defined "functional equivalent" approach of *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148 (5th Cir. 1979);

see also, e.g., *Gulf Oil Corp. v. Dyke*, 734 F.2d 797, 809 (T.E.C.A. 1984). That approach—effectively criticized in *In re Midwest Milk Monopolization Litigation*, 529 F. Supp. 1326, 1337-38 (W.D. Mo. 1982), aff'd, 730 F.2d 528 (8th Cir. 1984); Comment, *A Legal and Economic Analysis of the Cost-Plus Contract Exception in Hanover Shoe and Illinois Brick*, 47 U. Chi. L. Rev. 743, 756-70 (1980), cf. *Abbotts Dairies Division of Fairmont Foods v. Butz*, 584 F.2d 12, 16-17 (3d Cir. 1978), and found to be inapplicable to conditions in the beef industry itself in *In re Beef Industry Antitrust Litigation*, 710 F.2d 216, 219-20 (5th Cir. 1983)—requires elaborate analysis of the incidence of a cost increase, which is precisely the analysis that the Court disparaged in *Illinois Brick*. Our approach does not require this. We have formal cost-plus pricing in this case rather than its "functional equivalent." We have formal cost-plus pricing, and more: a contract that required 100 percent passing on, and an acknowledgment of 100 percent passing on in every kilowatt hour resold to CILCO's residential consumers.

To determine whether (or to what extent) this case is within the rule of *Illinois Brick*, we must consider the reasons for confining the right to sue to the direct purchaser; for it is the reasons behind a rule that determine its scope. First, because the direct purchaser is closer to the violation and hence more likely to discover it, we want to make sure that he has a strong incentive to bring the violator to book, and we do this by holding out to him the prospect of recovering the entire damages caused by the violation if he wins the suit. Second, it is difficult to apportion damages between direct and indirect purchasers by the methods of litigation. A direct purchaser who finds himself paying a higher price for inputs would love to pass on all of the additional cost to his customers in the form of a higher price, but he cannot do so, because a price that much higher will so reduce the demand for his product that his profits will fall unacceptably. (If the higher price were optimal, the firm would have raised its price without waiting for its costs to increase.) The optimal adjustment by an unregulated firm to the increased cost of

the input will always be a price increase smaller than the increase in input cost, and this means that the increased cost will be divided between the two tiers, the direct and indirect purchasers—but in what proportions will often be hard to determine, even by sophisticated techniques of economic analysis. This is a central insight of the *Illinois Brick* decision. An additional complication that further demonstrates the wisdom of the decision is that the higher input price may induce the direct purchaser to use more of an alternative input, and this substitution will affect the proportion of the initial overcharge that the direct purchaser can recoup.

Where the direct purchaser has a cost-plus contract with his customers that requires them to buy a fixed quantity, the reasons for confining the right to seek damages to the direct purchaser cease to be fully persuasive. There is no longer a problem of apportionment, because the whole of any price increase will have been passed on to the customers by virtue of the contract. Yet the second reason for confining the right to seek damages to the direct purchaser survives: he has better information about the violation. And despite the cost-plus nature of the contract, he has everything to gain from suing. He will not have to share any of the damages that he recovers with his customers unless the contract contains a clause (or a court is persuaded to adopt an imaginative conception of unjust enrichment) that entitles them to any rebate he might receive, probably years later, on an input used in performing his side of the bargain. Nevertheless the Supreme Court has said that the indirect purchaser may sue if he has a cost-plus contract with the direct purchaser.

In the present case, where cost-plus pricing is imposed by public utility regulation rather than by a purely private, purely voluntary contract, the reasons balance out slightly differently, but the case for applying the cost-plus exception of *Illinois Brick* is no weaker once the balance is restruck. The public utility has less to gain from suit than the direct purchaser in the case of the purely private contract. The public utility commission may force the util-

ity to pass on to the consumers any and all damages that the utility recovers, and if it does utilities will have no incentive to sue because they will have nothing to gain from suit. In the present case CILCO finally did sue—but not until 1987, by which time the present suit was far advanced and the statute of limitations with regard to the damages incurred by residential customers in the present suit either had run or was about to run; and the CILCO case has remained dormant pending our decision of the appeal. CILCO seems a most reluctant suitor, and why shouldn't it be? It has little or nothing to gain by such a suit. Indeed, one might argue that public utility regulation (to the extent effective—admittedly a potentially big if) so far identifies a public utility with its customers as to bring the case within the separate exception recognized in *Illinois Brick* for situations in which the direct and indirect purchaser are under common control. See 431 U.S. at 736 n. 16, 97 S.Ct. at 2070 n. 16.

Although the amount of gas purchased by a utility's customers is not fixed in their contract with the utility (it would be absurd for consumers to commit to a fixed quantity; their need for gas varies with the weather!), the special character of a public utility eliminates the problem of apportionment, here with respect to the only class of customers that we believe should be allowed to sue, the residential customers. The retail distribution of natural gas through a grid of pipes to the customers' homes or places of business is a natural monopoly, *Omega Satellite Products Co. v. City of Indianapolis*, 694 F.2d 119, 123, 126 (7th Cir. 1982); so, in the absence of regulation, a gas utility would charge a monopoly price. Although the efficacy of public utility rate regulation has been questioned (see, e.g., Stigler & Friedland, *What Can Regulators Regulate? The Case of Electricity*, 5 J. Law & Econ. 1 (1962); Moore, *The Effectiveness of Regulation of Electric Utility Rates*, 36 So. Econ. J. 365 (1970)), the facts of this case suggest, and the parties seem to agree, that residential natural-gas rates in Illinois are lower because of regulation than they would be in an unregulated mar-

ket, implying that CILCO has unused monopoly power in that market, which it exploited by passing on the full overcharge by Panhandle. The situation in the industrial market is different. Some industrial consumers of natural gas have good alternatives, and as to them CILCO apparently had no unused monopoly power that would have enabled it to shift the whole of the cost increase to them. Instead CILCO sought and obtained regulatory permission to reduce its profit margin on sales to these customers, thereby offsetting in part the higher rates enabled by the automatic pass-through provision.

CILCO's dealings with its industrial customers show why the absence of a quantity provision in a contract can make a difference. Since the industrial customers were not obligated to take a fixed (or their required) quantity of natural gas, and since they had competitive alternatives, CILCO's profit-maximizing course of action was to swallow part of the overcharge rather than try to pass it on dollar for dollar in the form of higher rates. But its residential consumers unlike its industrial customers had no good alternatives to natural gas (of which CILCO was the sole purveyor), at least in the short term, and CILCO's profit-maximizing course of action was therefore to allow its rates to them to rise by the exact amount that its gas costs rose as a result of Panhandle's alleged overcharge. It was not only the absence of competition but the presence of regulation that made this the profit-maximizing course of action; regulation is a stand-in for the quantity requirement in an ordinary contract. Apparently rate regulation had succeeded in keeping CILCO's rates to a level where an increase in those rates was bound to increase the firm's revenues because the price increase (1) would not be offset by an equal or greater proportional decline in its sales and (2) would lead to a reduction in the firm's total costs (consumers would buy less, even if only a little less, at the higher price). CILCO therefore had every incentive to raise its price by the full amount allowed by the regulatory commission—which was the full amount of the gas overcharge. And it did it.

The significance of the regulatory setting is that if regulation keeps a utility's rates below what it would like to charge, the utility will raise those rates by the full amount allowed by the regulatory commission unless such an increase would carry the utility above its optimum rate. An unregulated firm would not do that, since as we have noted an unconstrained profit maximizer will always find it in its best interest to swallow a part of any cost increase that it experiences unless its customers are committed to a fixed quantity. It is unclear from the record in this court how generous the commission's allowance was; the commission may have allowed CILCO to double its rates—yet even so, if regulation forced CILCO to charge half or less of its preferred price, CILCO would pass on the entire cost increase. No one suggests that CILCO in fact absorbed any part of the increase, so far as sales to its residential customers were concerned.

The mechanics of the pass-through provision are pertinent. The "Uniform Purchase of Gas Adjustment Clause" that Illinois by statute requires CILCO to include in its contracts not only entitled but directed CILCO, if it paid Panhandle an extra penny per million cubic feet of gas, to add exactly one penny to each customer's bill for every Mcf of gas sold to that customer. So if all of its customers had continued buying the same amount of gas CILCO would have suffered no loss on account of the overcharge. To the extent that CILCO lost residential sales because it was charging a higher price—and no doubt it lost some sales—the loss was not passed on to CILCO's customers (at least in any sufficiently direct way to escape the rule of *Illinois Brick*) and hence is not a component of the customers' damages. But by the same token this is not a case where successive links in the chain of distribution are claiming damages in respect of the same transaction. There are, instead, two completely different sets of transactions. One consists of sales to CILCO followed by resale to its residential customers; on these sales the entire overcharge came to rest on the residential customers and they alone suffered damage and can (on the view we take of

the case) recover damages. The other set of transactions consists of the sales that CILCO lost because some customers balked at the higher rates; on these sales (or rather nonsales) the only loser is CILCO, and only CILCO can sue. There is no suggestion that the residential customers are suing or could sue to recover incidental expenses incurred by reducing their purchases of natural gas—the cost of an extra sweater or a more efficient furnace or better insulation.

To illustrate the distinction between the two types of loss in this case, suppose that the price to CILCO's residential customers before the (alleged) overcharge by Panhandle was $1 per Mcf, the overcharge was 10¢ per Mcf, and by operation of the Uniform Purchase of Gas Adjustment Clause the retail price rose to $1.10 because CILCO made no offsetting reduction in another component of the price, as it did with its industrial customers. And suppose that at the new, higher price CILCO sold only 950,000 Mcf, while at the old price it had sold 1,000,000 Mcf, and that nothing plausibly accounts for the decrease in sales except the price increase, which induced consumers to use less gas. Cf. *Illinois Power Co. v. Commissioner*, 792 F.2d 683, 687-88 (7th Cir. 1986). The loss to each consumer would be the number of Mcf he bought at the new price times 10¢; the loss to CILCO would be its lost profits on the sales it did not make.

Thus there can be no problem of apportionment in the suit on behalf of the residential customers. Those customers are not seeking damages for gas they did not buy, and the damages for the gas they did buy can simply be read off from their gas bills. (Well, almost: at the beginning of each year the utility estimates the amount of rate increase necessary to cover any increase in its gas bill, and there is an adjustment at the end of the year based on actual experience.) Since CILCO can sue for its lost sales (this may be a component of its belatedly filed suit against Panhandle, although that is unclear from the complaint), there can be more than one set of plaintiffs. But each set will be suing in respect of different sales—not, as in *Illinois Brick*, the same sales.

We have said that proof of the indirect purchasers' loss would be straightforward. Proof of CILCO's lost sales would also be straightforward—at least as straightforward as is possible in an antitrust case. It would be a matter of comparing the utility's sales before and after the increase in gas prices, after correcting for other factors besides the increase that might have affected those sales. Such correction is not always easy, but it is a conventional aspect of calculating damages in antitrust cases; it has to be done in every case where the plaintiff claims to have lost sales because of the defendant's unlawful conduct and the defendant argues that the loss was due partly or entirely to other factors. See, e.g., *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 264, 66 S.Ct. 574, 579, 90 L.Ed. 652 (1946); *Fishman v. Estate of Wirtz*, 807 F.2d 520, 551 (7th Cir. 1986); *id.* at 578 (partial dissent); *Olympia Equipment Leasing Co. v. Western Union Telegraph Co.*, 797 F.2d 370, 382-83 (7th Cir. 1986). More important, it is a problem unrelated to the problem the Supreme Court wrestled with in *Hanover* and *Illinois Brick*. The Court was concerned with the situation where two purchasers of the same thing—the initial purchaser and the purchaser from the initial purchaser—are or could be complaining that both had been hurt, and the problem is to apportion the loss between them. Here only the residential consumers can complain about a loss from the overcharge on the gas they bought, while only CILCO can complain about a loss caused by the overcharge on gas that the residential consumers did not buy.

All this is not to say that *Illinois Brick* has no application to cases where the direct purchaser is subject to rate regulation. Although cost-plus is the spirit of rate regulation, the flesh is weak and often therefore the utility has considerable flexibility in pricing, much like an unregulated firm. Indeed, to the extent that it operates free from effective rate regulation—either because it faces competition which constrains its rates below the regulated level (apparently CILCO's situation with its industrial customers), or because the regulators are unable to prevent it

from charging monopoly prices to its captive customers—the utility's situation is identical to that of an unregulated firm. But, if so, this will be revealed in the utility's decision to swallow some of the cost increase, as CILCO did with its industrial customers. In the case of its residential customers, regulation must have succeeded in forcing the utility to operate in a region of its demand curve where 100 percent passing on of any cost increase was the optimal strategy for the utility to follow, for that was the strategy it *did* follow.

With the rapid and unanticipated increases in fuel prices during the 1970s, utilities pressed for and obtained the right to include automatic fuel pass-through provisions in their contracts with customers, provisions that would allow the utility to pass on every dollar in higher prices that it paid for gas or other fuels to its customers without going through the time-consuming process of obtaining regulatory authorization to raise rates. Such provisions are also found in unregulated contracts, and should be treated the same there when the contract requires the buyer to take either a fixed quantity or his requirements, since a buyer cannot reduce his purchases under a requirements contract merely because he is dissatisfied with the terms of the contract as they have worked themselves out. See *Empire Gas Corp. v. American Bakeries Co.*, 840 F.2d 1333, 1340-41 (7th Cir. 1988); *Wilsonville Concrete Products v. Todd Building Co.*, 281 Ore. 345, 352, 574 P.2d 1112, 1115 (1978); *Royal Paper Box Co. v. E.R. Apt Shoe Co.*, 290 Mass. 207, 195 N.E. 96 (1935); *Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp.*, 130 F.2d 471, 473-74 (3d Cir. 1942); White & Summers, Handbook of the Law Under the Uniform Commercial Code 126 (2d ed. 1980). (This example shows, by the way, why a rigid test of fixed quantity would be a senseless limitation on the cost-plus exception of *Hanover Shoe* and *Illinois Brick*—a buyer under a requirements contract does not have discretion as to the amount to take under the contract.) If on the other hand the buyer has complete flexibility as to how much to buy, a cost-plus provision

is ineffectual; the buyer can always condition an agreement to buy a specific amount on the seller's agreeing to modify the contract by reducing the price. This is another reason for supposing that an agreement to take a fixed quantity, or, what is equivalent for these purposes, an agreement to take one's requirements, is implicit in the cost-plus exception rather than an independent requirement for invoking it. The unexhausted monopoly power of a regulated utility takes the place of a fixed-quantity or requirements provision. The utility can force the whole of the cost increase through to its residential customers without sacrificing any profits, *and did so.*

But we do not think that the industrial customers should be allowed to sue for damages. By cutting its profit margin to them CILCO raised its price by less than the increase in gas cost, and while the division of that increase between the utility and its industrial customers is easy to ascertain—precisely because the utility was required to get approval for reducing its profit margin—we are unwilling to complicate the administration of *Illinois Brick* by trying to distinguish between difficult and easy apportionment cases. And the Supreme Court seemed unwilling to listen to such arguments. But for every cubic foot of gas bought by a residential customer, we *know* that the whole overcharge was passed on to the customers in accordance with the fuel pass-through provision of their contract with CILCO, and we know why (regulation plus the residential consumers' lack of alternatives).

It might seem an unimportant detail whether a buyer reacts to an overcharge by raising its price by less than the overcharge (as CILCO did with its industrial customers), thus losing fewer customers, or by raising its price by the full overcharge and thereby losing more customers than it would if it swallowed part of the overcharge. But in the second case the problem of apportioning losses on the same sales does not arise. It might also seem impermissible under *Illinois Brick* to inquire into the question whether there really was 100 percent passing on; but the Court announced an exception for cases

where there is a cost-plus contract, and there is such a contract here—the automatic fuel pass-through provision. Although it is not a contract for a fixed quantity or (what is equivalent for purposes of the exception) the buyer's requirements, the existence of public utility regulation is an adequate substitute in the circumstances.

True, we can never be absolutely certain that regulation has resulted in a 100 percent pass through; for all we know, CILCO would have sought a rate increase but for the gas overcharge, and by forbearing to do so in effect absorbed part of the overcharge. But by the same token, the seller under a fixed-quantity cost-plus contract might forbear to insist on a 100 percent pass through in order to curry favor with the buyer for the sake of future deals. No counterfactuals are certain, but the doubts here are too small to warrant our insisting that this potentially serious antitrust violation, which may have caused consumers of natural gas to pay almost $50 million in higher prices, shall go unremedied, as it may if we accept Panhandle's view of the scope of *Illinois Brick*. Whether the cost-plus exception might embrace other situations in which the direct purchaser has a cost-plus contract with the indirect purchasers but the contract does not require the indirect purchasers to buy a fixed quantity (or their requirements) is not a question that we need decide in this case.

The suit on behalf of the residential customers is within the scope of the cost-plus exception to the rule of *Illinois Brick* as we understand it, and we therefore affirm the denial by the district court of the defendant's motion to dismiss the complaint insofar as the complaint seeks damages on behalf of CILCO's residential customers. We reverse insofar as the court allowed suit on behalf of the industrial customers for damages. We express no view of the antitrust merits or of the propriety of the requests for injunctive relief, and we award no costs in this court.

AFFIRMED IN PART AND REVERSED IN PART.

CUDAHY, *Circuit Judge*, concurring:

I concur without reservation in the majority's application of the *Illinois Brick* doctrine to the facts of this case. A bar to indirect purchaser suits would make very little sense if it were extended to the regulated natural gas distribution business where full purchased gas cost pass-through is incorporated in the retail rates. The PGA clause transforms the transaction into the very epitome of a cost-plus contract. Likewise, because residential gas demand is inelastic in the short run due to the unavailability to residential customers of substitute fuels, a rough approximation of a fixed quantity term is present, whether or not required by *Illinois Brick*.

The Natural Gas Pipeline Association of America, in an amicus brief, argues that if the antitrust suit were left to the direct purchaser (CILCO), its regulator (the Illinois Commerce Commission) could and would direct CILCO to pass on the sums recovered to its customers. The customers would, therefore, be in as good a position as if the Attorney General had sued directly on their behalf. I believe this is essentially correct. CILCO has in fact now brought suit in this matter, presumably because the panel decision cast doubt on whether the Attorney General could maintain the action on behalf of consumers.

Under the practical facts of regulation CILCO would ordinarily have a greater incentive to bring this litigation than economic theory suggests. An informal suggestion from its regulators that suit was appropriate to protect customers would ordinarily send CILCO to court. Further, regulation allows CILCO to recognize only its *prudently incurred* expenses for ratemaking purposes. Presumably, a distribution company's purchase of pipeline gas at prices inflated by antitrust violations could be challenged as an imprudent incurrence of operating expenses. An antitrust recovery would at least partially offset any imprudence in the initial purchasing decision. In any event, in its next rate case, the distribution company would be hard pressed to justify its payment of illegally inflated

prices if neither it nor the Attorney General had sought to press the antitrust claim.

Nonetheless, I suspect that considerations such as the difficulty of settlement might lead CILCO to prefer an Attorney General's lawsuit to its own. Presumably, a settlement by the state Attorney General with the pipeline supplier would be accepted as fully arm's length and justifiable. Were CILCO to settle, however, the aggressiveness of its stance might be questioned by the regulators in light of its ongoing relationship with the supplier and, of course, its settlement would in all probability have to be approved by the regulatory authority. It therefore seems to me that, in the final balance, suit by CILCO is not necessarily preferable to suit by the Attorney General on behalf of the residential customers.

FAIRCHILD, *Senior Circuit Judge*, with whom BAUER, *Chief Judge*, and CUMMINGS and MANION, *Circuit Judges*, join, concurring in part, dissenting in part.

I concur in reversal as to the treble damage claims on behalf of industrial customers. I respectfully dissent from affirmance with respect to such claims on behalf of residential customers.

The residential customers purchase from CILCO, and are only indirect purchasers from Panhandle, who allegedly overcharged CILCO. Because the rates charged by CILCO reflect, appromixately at least,[1] the actual cost of gas, it is claimed that the residential customers were "injured" so as to be entitled to treble damages under § 4 of the Clayton Act, 15 U.S.C. § 15,[2] by reason of the pass-on of the overcharge.

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[1] The process of adjustment of rates charged by CILCO to rates paid is described in the panel opinion. 839 F.2d at 1208 n.2.

[2] Section 4 provides that

> [A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor . . . and shall recover threefold the damages by him sustained. . . .

The Supreme Court has "held that, except in certain limited circumstances, a direct purchaser suing for treble damages under § 4 of the Clayton Act is injured within the meaning of § 4 by the full amount of the overcharge paid by it . . .". *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 724, 97 S. Ct. 2061, 2064, 52 L.Ed.2d 707 (1977) (footnote omitted) (interpreting the rational of *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481, 494, 88 S.Ct. 2224, 2232, 20 L.Ed.2d 1231 (1968)). *Hanover Shoe* had rejected an attempt by an antitrust defendant to establish that plaintiff direct buyer had not been "injured" within the meaning of § 4 because the direct buyer had passed on any overcharge. In *Illinois Brick*, plaintiff was asserting a claim on behalf of indirect purchasers that they had been "injured" by a pass-on of an overcharge. The Court reaffirmed *Hanover Shoe* and decided that its root principle (that, with limited exceptions, the full injury of the overcharge falls upon the direct purchaser) must apply to and prevent treble damage claims on behalf of an indirect purchaser, as well as apply to and permit claims of a direct purchaser.

Both *Hanover Shoe* and *Illinois Brick* dealt with the question presented as one of statutory construction of § 4. Indeed in *Illinois Brick*, the Court said,

> In considering whether to cut back or abandon the *Hanover Shoe* rule, we must bear in mind that considerations of *stare decisis* weigh heavily in the area of statutory construction, where Congress is free to change this Court's interpretation of its legislation.

431 U.S. at 736.

Illinois Brick described only two exceptions to its general rule that the direct purchaser is injured by the full amount of the overcharge. One, "where the direct purchaser is owned or controlled by its customer," 431 U.S. at 736, n.16, is clearly inapplicable here. The other, which originated in *Hanover Shoe*, is where an overcharged direct buyer has a pre-existing cost-plus contract for a fixed quantity. 431 U.S. at 736, 97 S.Ct. at 2069.

Judge Posner's opinion for this court suggests that the reference to "a fixed quantity" does not have controlling significance. *Ante*, pp. 3 and 4. Particular aspects of the *Hanover Shoe* and *Illinois Brick* opinions persuade me otherwise.

The *Hanover Shoe* opinion, in recognizing that "a pre-existing 'cost-plus' contract" might provide an exception to its rule against a pass-on defense, did not expressly require a fixed quantity element. 392 U.S. at 494, 88 S.Ct. at 2232. That element may well have been implied, for the Court referred to the cost-plus contract as "thus making it easy to prove that [the direct buyer] has not been damaged." *Ibid.* In *Illinois Brick*, Justice White, who wrote for the Court in both cases, expressly referred to the fixed quantity element and took pains to explain why it was important:

> But this Court in *Hanover Shoe* indicated the narrow scope it intended for any exception to its rule barring pass-on defenses by citing, as the only example of a situation where the defense might be permitted, a pre-existing cost-plus contract. In such a situation, the purchaser is insulated from any decrease in its sales as a result of attempting to pass on the overcharge, because its customer is committed to buying a fixed quantity regardless of price. The effect of the overcharge is essentially determined in advance, without reference to the interaction of supply and demand that complicates the determination in the general case.

431 U.S. at 735-36, 97 S.Ct. at 2069-70.

This court's opinion concedes that no doubt CILCO lost residential sales because of the higher price, and because of the overcharge if there was one. *Ante*, p. 896. It follows from *Hanover Shoe* and *Illinois Brick* that when some injury falls on the direct purchaser because of the overcharge, it all does.

After considering and rejecting proposed exceptions, the Court said "As we have noted, *supra* at 735-736, [97 S.Ct. at 2069-2070], *Hanover Shoe* itself implicitly discouraged the creation of exceptions to its rule barring pass-on defenses, and we adhere to the narrow scope of exemption indicated by our decision there." 431 U.S. at 745, 97 S.Ct. at 2074.

As I read *Illinois Brick*, the Supreme Court did not leave it to the discretion of the lower courts to create new exceptions for situations which fall within some range of approximation of the exceptions defined by the Court. And that is what this court appears to be doing with respect to the claims of the residential customers.

Supreme Court, U.S.
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No. 88-658

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

v.

STATE OF ILLINOIS, ex rel. NEIL F. HARTIGAN, Attorney General of the State of Illinois,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

RESPONDENT'S OBJECTIONS TO MOTIONS FOR LEAVE TO FILE BRIEFS *AMICUS CURIAE*

Of Counsel:

NEIL F. HARTIGAN
Attorney General of the
State of Illinois
100 West Randolph Street
12th Floor
Chicago, Illinois 60601

EDWARD J. BURKE
RAYMOND J. SMITH *
MARY PATRICIA BURNS
Special Assistant Attorneys
General
BURKE AND SMITH CHARTERED
55 West Monroe Street
Suite 1800
Chicago, Illinois 60603
(312) 853-3230

* (Counsel of Record)

Attorneys for Respondent

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

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RESPONDENT'S OBJECTIONS TO MOTIONS FOR LEAVE TO FILE BRIEFS *AMICUS CURIAE*

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Pursuant to Rules 36 and 42 of the Rules of the Court, respondent State of Illinois ("State") respectfully files these objections to the motions filed by the Kansas Power and Light Company ("KPL") and the Interstate Natural Gas Association of America ("INGAA") for leave to file briefs as *amicus curiae*.

Respondent withheld consent and specifically objects to the motions filed by KPL and INGAA for a number of reasons, not the least of which is that neither KPL nor INGAA provided respondent with a copy of its brief as *amicus curiae* or informed respondent of the proposed nature and content of its brief prior to seeking respondent's consent. In fact, respondent did not receive KPL's and INGAA's motions and briefs until four and five days, respectively, after respondent filed its brief in opposition to the petition for writ of certiorari. Now having reviewed said motions, respondent objects to their filing on the ground that the motions fail to demonstrate that either KPL or INGAA have a legitimate interest in the outcome of the question before the Court on petition for writ of certiorari. Further, no new probative argument has been advanced by either of the proposed *amici* on the question presented by the petition.

1. INGAA's primary message to the Court is that the members of its association join the petitioner in advocating that, if there must be antitrust enforcement against pipelines, the designated plaintiff of their choice is the local distribution company ("LDC") (INGAA at 3-6).[1] The request of the pipelines is understandable for not only is CILCO captive to the petitioner, it is beholden to the petitioner as evidenced by the uncontested fact that in 1983 and 1984, when the petitioner's anticompetitive overcharge was at its highest, CILCO's corporate profits were at a record level. No wonder INGAA promotes the LDC as being the "appropriate party in the dispute for purposes of achieving settlement." (INGAA at 8). The Court in *Illi-*

[1] "INGAA" refers to the Motion for Leave to File Brief as *Amicus Curiae* and Brief of Interstate Natural Gas Association of America.

nois Brick Co. v. Illinois, 431 U.S. 720 (1977), however, was in no way concerned with the antitrust violator's choice of adversary.

2. Next, INGAA claims that if certiorari is denied it will have difficulty in formulating an overall policy of deciding in which states its members may, with impunity, exact supracompetitive prices from their captive residential consumers (INGAA at 8). *Illinois Brick* should have already informed the members that regardless of which state is involved, if the captive residential consumers have a cost-plus contract with the LDC those consumers may exercise their *right* to sue under §4 of the Clayton Act. *Illinois Brick*, 431 U.S. at 736-737; 15 U.S.C. §15.

3. Lastly, INGAA, on behalf of the interstate pipelines, feigns concern for the efficient allocation of damages (INGAA at 6-8). This issue, however, is premature in light of the interlocutory nature of the petitioner's appeal and the fact that the district court has not ruled on the issue of liability after the trial on the merits. Nevertheless, allocation of damages will not be a problem. The Seventh Circuit has indicated that proof of the residential consumers' damages will be straightforward: "[The residential] customers are not seeking damages for gas they did not buy, and the damages for the gas they did buy can simply be read off from their gas bills" (R. App. at 10).[2] INGAA's entire argument is premised on the faulty assumption that unless the direct purchaser is the plaintiff, it will not cooperate in the distribution of damages. Here, the officers and employees of CILCO were the principal witnesses for the State on the issue of liability and fully cooperated with the State and the district

[2] "R. App." refers to the Respondent's Appendix.

court throughout the entire three and one-half years of litigation. That cooperation will continue with CILCO making available to the State whatever records are necessary to determine the appropriate allocation of damages to CILCO's residential customers.

4. The arguments raised by KPL in its motion and brief simply mirror the contentions raised by petitioner. KPL argues that even if there is no absorption of the overcharge by the direct purchaser and, therefore, no apportionment, *Illinois Brick* would still mandate that KPL be allowed to continue its action for that overcharge (KPL at 6-9).[3] KPL's real quarrel is with the decision of the Court in *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), not with the decision of the Seventh Circuit in this case. It is *Hanover Shoe* that dictates that where there is a cost-plus contract between the direct and indirect purchaser, as the Seventh Circuit found here, the defendant can assert the pass-on defense against the direct purchaser. Despite the fact that KPL would face the *Hanover Shoe* defense and that its captive residential customers, who were the actual victims of the overcharge, stand ready to prosecute the violation, KPL amazingly insists that it—and not its customers—should sue for the overcharge.

Consistent with this apparent conflict with its residential customers, KPL joins with the petitioners in mischaracterizing the Seventh Circuit's holding as being the creation of a "functional equivalent" or "regulatory equivalent" exception. The fact that the Seventh Circuit expressly found in this case that the CILCO-residential consumer

[3] "KPL" refers to the Motion for Leave to File Brief *Amicus Curiae* and Brief filed by the Kansas Power and Light Company.

relationship was a cost-plus contract, and *not* a functional equivalent of one, has been addressed by respondent in its brief in opposition (Resp. at 6-8, 11-12).[4]

For these reasons, respondent respectfully requests that the motions of KPL and INGAA for leave to file briefs as *amicus curiae* be denied.

Respectfully submitted,

EDWARD J. BURKE
RAYMOND J. SMITH *
MARY PATRICIA BURNS
Special Assistant Attorneys General
BURKE AND SMITH CHARTERED
55 West Monroe Street
Suite 1800
Chicago, Illinois 60603
(312) 853-3230

Attorneys for Respondent

* (Counsel of Record)

Of Counsel:

NEIL F. HARTIGAN
Attorney General of the State of Illinois
100 West Randolph Street
12th Floor
Chicago, Illinois 60601

Dated: November 22, 1988

[4] "Resp." refers to the Brief in Opposition to the Petition for Writ of Certiorari filed by respondent State of Illinois.

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No. 88-658

IN THE

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PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

v.

STATE OF ILLINOIS, ex rel. NEIL F. HARTIGAN, Attorney General of the State of Illinois,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY BRIEF OF PETITIONER

Of Counsel:

JOHN A. SIEGER
IRWIN A. BAIN
PANHANDLE EASTERN
PIPE LINE COMPANY
5400 Westheimer Court
Houston, Texas 77056
(713) 627-5400

PAUL H. LARUE *
JURIS KINS
GREGORY G. WROBEL
JAMES M. MROWICKI
ANDREW M. GARDNER
CHADWELL & KAYSER, LTD.
8500 Sears Tower
Chicago, Illinois 60606
(312) 876-2100

Attorneys for Petitioner
PANHANDLE EASTERN PIPE
LINE COMPANY

* Counsel of Record

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

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On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY BRIEF OF PETITIONER

Petitioner, Panhandle Eastern Pipe Line Company, submits this Reply Brief to show that this case merits the issuance of a Writ of Certiorari. There is a serious conflict between the Seventh Circuit's decision and *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), and serious conflicts among the circuits on the application of the *Illinois Brick* decision.[1]

[1] Respondent attempts to make a point by including the "corrected" *en banc* opinion, as reported in 852 F.2d 891 (7th Cir.

(Footnote continued on following page)

I. *Illinois Brick* Neither Requires Nor Permits A Case-By-Case Factual Inquiry To Determine Whether The Reasons For The General Bar Exist

Respondent is wrong in stating that Panhandle's position is that *Illinois Brick* "prohibits a factual analysis, especially from an economic perspective, as to whether a cost-plus contract exists." Resp. Br. 8-9. Panhandle's position is that *Illinois Brick* neither requires nor permits a factual analysis to determine in each case whether the underlying policy reasons for the general bar exist. Pet. 8-9. This Court rejected a request that the holding in *Hanover Shoe, Inc. v. United Machinery Corp.*, 392 U.S. 481 (1968), (and thus the holding in *Illinois Brick*) be limited to its "particular factual context." *Illinois Brick*, 431 U.S. at 729, 743-45

Moreover, respondent quotes *Illinois Brick* out of context by stating that the decision "necessitates a factual analysis to determine whether it is 'easy to prove that [the direct purchaser] has not been damaged;' or in other words 'that the overcharge has not been absorbed by the direct purchaser.' " Resp. Br. 9. That quotation from *Illinois Brick* simply explains why a limited exception for a preexisting, fixed quantity, cost-plus contract should be allowed. *Illinois Brick*, 431 U.S. at 732 n.12. It does not, as respondent suggests, authorize lower courts to reex-

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[1] *continued*

1988), in its appendix; Panhandle's appendix contains the *en banc* opinion the court served on the parties. Resp. Br. 1-2. However, respondent explains neither the nature nor the significance of the correction. In fact, the correction consists of substituting "industrial" for "residential" at R. App. 12 (line 5). This correction is without significance because the error is obvious; Panhandle recognized it as such, and did not rely upon it in its petition.

amine the facts on a case-by-case basis to determine whether the general bar should apply where no such contract exists.

Furthermore, contrary to respondent's argument, the Seventh Circuit *did* rely on "simplifying economic assumptions." Resp. Br. 9. It did so in positing—as the basis for discarding the fixed quantity requirement of the cost-plus exception—that "regulation must have succeeded in forcing [CILCO] to operate in a region of its demand curve where 100 percent passing on of any cost increase was the optimal strategy for the utility to follow." App. A-12.[2] This analysis is in direct contravention of *Illinois Brick*. *See* 431 U.S. at 742.

The general bar of *Illinois Brick* is based on this Court's construction of § 4 of the Clayton Act, 15 U.S.C. § 15, that the direct purchaser is the "person injured" and is injured by the full amount of the overcharge. The Seventh Circuit invaded the province of this Court and of Congress by reexamining the reasons for the Court's settled construction of § 4.

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[2] Apparently this Court's rejection of elasticity studies in *Illinois Brick*, 431 U.S. at 742, persuaded Judge Posner to omit from his opinion for the court *en banc* the explicit references to demand elasticity contained in his dissent to the panel's opinion. Nevertheless, the analysis in both opinions employs this concept.

Moreover, simplifying assumptions as to elasticity cannot be made. For example, respondent states that gas sales to residentials increased 13% in 1984. Resp. Br. 5. However, respondent fails to state that in 1984, Panhandle had reduced its prices from those in 1983. DX 1404-1. In 1983, when Panhandles gas prices increased significantly over previous years, CILCO's gas sales decreased 13 percent overall and 20 percent as to residentials. Appendix of Panhandle to the Seventh Circuit, pp. 301, 314, filed Oct. 28, 1985.

II. Clear Conflicts Exist Among The Circuits

Contrary to respondent's statement, Panhandle did not "mislead this Court" in stating that the Seventh Circuit conceded the conflict. Resp. Br. 11-12. The Seventh Circuit clearly acknowledged a conflict when it characterized the decisions of the panel and of the Third, Eighth, and Ninth Circuits as having read the cost-plus exception "narrowly" to require a preexisting fixed quantity provision, and then proceeded to redefine it expansively as not requiring such a provision. App. A-3.

The Seventh Circuit's statement that the court had before it a "stand-in for the quantity requirement in an ordinary contract" is a further acknowledgement that a conflict exists with such circuits as the Second, Third and Fourth, which have required an *actual* fixed quantity provision.[3] Resp. Br. 12.

Respondent's argument that Panhandle has raised for the first time the "pre-existence requirement" is false. Resp. Br. 12-13. Panhandle cited *Jewish Hospital Association v. Stewart Mechanical Enterprises, Inc.*, 628 F.2d 971 (6th Cir. 1980), *cert. denied*, 450 U.S. 966 (1981), to

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[3] Respondent correctly recognizes that the Seventh Circuit's decision conflicts with *In re Wyoming Tight Sands Antitrust Litigation*, 1988-2 Trade Cas. (CCH) ¶ 68,164 (D. Kan.), *appeal docketed*, Nos. 88-8042, 88-8043 (10th Cir. 1988), but is wrong in stating that the *Tight Sands* court relied on the panel decision. Resp. Br. 11 n.6. That court independently, by its own analysis, concluded that *Illinois Brick* and *Hanover Shoe* barred indirect purchaser damage claims in that case. "The opposing parties' arguments have failed to convince this court of the inapplicability of *Hanover Shoe* and *Illinois Brick*." *Id.* at 59,099-100. The court merely recognized that its decision was consistent with the panel decision. "This court agrees with the analysis and decision in *Panhandle Eastern*." *Id.* at 59,100.

the Seventh Circuit in arguing the need for a *preexisting*, fixed quantity contract between the direct and indirect purchasers. Brief of Panhandle to the Seventh Circuit, p. 30, filed Oct. 28, 1985.

III. Whether There Is A Total Pass-Through To Indirect Purchasers Is Immaterial

Respondent's reliance upon its claim that the entire alleged overcharge was passed on to CILCO's "residential" customers is misplaced. Resp. Br. 6, 8, 9. The amount of overcharge passed on is wholly irrelevant to application of the indirect purchaser bar or the pass-on defense.[4] This Court in *Illinois Brick* recognized that the rule may deny recovery to indirect purchasers who are in fact injured by an antitrust violation, but determined that the reasons in favor of the rule outweigh this concern. *Illinois Brick*, 431 U.S. at 746.

IV. The Seventh Circuit's Decision Impermissibly Permits Suits By Both Direct And Indirect Purchasers

Respondent's attempt to rationalize the coexistence of suits by both the direct and indirect purchasers is misplaced. Resp. Br. 9-10. No amount of rationalization can overcome this Court's articulation that only one suit is

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[4] Respondent's assertion that a utility (such as CILCO) under the PGA provision passes through "100 percent of its cost of gas; an LDC may not absorb one cent of its cost of gas sold" is a mischaracterization of a utility's rate mechanism. Resp. Br. 4. Even the Seventh Circuit did not accept this argument, but recognized that CILCO can and did absorb gas costs by lowering the other components of its rates, the PGA notwithstanding. App. A-13. As the Seventh Circuit also recognized, gas costs also can be absorbed by foregoing rate increases. App. A-14.

permitted—either by the direct purchaser under the rule of *Illinois Brick* or the indirect purchaser under the cost-plus exception to the rule. The Seventh Circuit decision stands alone. No other decision since *Illinois Brick* has allowed suits by both the direct and indirect purchasers to proceed. Moreover, in allowing the claims of the residential customers but disallowing the claims of the industrial customers, the Seventh Circuit had to classify customers, which is contrary to *Illinois Brick*. 431 U.S. at 744-45.

Respondent necessarily concedes that the Seventh Circuit's decision permits both suits, but argues that this does not present any problems of duplicative recovery. Resp. Br. 9-10. Respondent makes this argument despite the fact that CILCO seeks to recover the *same* alleged overcharge as does respondent on sales to the indirect purchasers. Respondent's suggestion that Panhandle "will be able to successfully assert a *Hanover Shoe* pass-on defense against CILCO" is self-serving, wholly gratuitous and of no legal significance. Resp. Br. 10. However, by merely having to make that suggestion respondent acknowledges that the prospect of duplicative damages is real.

CONCLUSION

For the reasons stated in the Reply Brief, and in the Petition for Certiorari, this Court should grant the Petition for Writ of Certiorari.

Respectfully submitted,

Of Counsel:

JOHN A. SIEGER
IRWIN A. BAIN
PANHANDLE EASTERN
PIPE LINE COMPANY
5400 Westheimer Court
Houston, Texas 77056
(713) 627-5400

PAUL H. LARUE *
JURIS KINS
GREGORY G. WROBEL
JAMES M. MROWICKI
ANDREW M. GARDNER
CHADWELL & KAYSER, LTD.
8500 Sears Tower
Chicago, Illinois 60606
(312) 876-2100

Attorneys for Petitioner
PANHANDLE EASTERN PIPE
LINE COMPANY

* Counsel of Record

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Respondent.

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF OF THE KANSAS POWER AND LIGHT COMPANY AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI

Of Counsel:
JOHN K. ROSENBERG
DAVID P. MUDRICK
THE KANSAS POWER AND LIGHT COMPANY
818 Kansas Avenue
Topeka, Kansas 66601
(913) 296-8128

BASIL W. KELSEY *
FRANK B. W. MCCOLLUM
CURTIS E. WOODS
MICHAEL F. SAUNDERS
SPENCER FANE BRITT & BROWNE
1400 Commerce Bank Building
1000 Walnut
Kansas City, MO 64106
(816) 474-8100
Attorneys for Amicus Curiae

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Pursuant to Rules 36 and 42 of the Rules of this Court, The Kansas Power and Light Company ("KPL") respectfully moves for leave to file the accompanying brief as *amicus curiae* in support of the granting of the petition for writ of certiorari. Petitioner has consented to the filing of this brief; respondent has not.

This *amicus* is familiar with the effect that the Seventh Circuit's decision will have upon persons other than petitioner and respondent. KPL is a plaintiff in antitrust litigation presently pending before the United States District Court for the District of Kansas, entitled *In re Wyoming Tight Sands Antitrust Cases*, Nos. 85-2349-S and Consolidated Cases. Currently pending before the United States Court of Appeals for the Tenth Circuit are appeals brought by the attorneys general for the States of Kansas and Missouri contesting the dismissal of their *parens patriae* claims in those consolidated cases brought on behalf of indirect residential purchasers of KPL's natural gas. Appeals Docketed, Nos. 88-8042, 88-8043. The attorneys general in those appeals maintain, *inter alia*, that the Seventh Circuit's decision in this case and its creation of an exception to the rule in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), is controlling and mandates the reinstatement of their *parens patriae* claims. Such a result will greatly complicate the discovery and trial of those consolidated cases and could cause the dismissal of certain claims brought by KPL allowing certain antitrust violations and millions of dollars in damages to go unremedied.

KPL has no direct interest in the outcome of the litigation between petitioner and respondent. However, KPL believes the issues raised by the Seventh Circuit's decision are of such overriding importance to the uniform interpretation of the federal antitrust laws and the successful prosecution of significant antitrust litigation in the District of Kansas, that review by this Court is required.

KPL therefore moves for leave to file the accompanying brief as *amicus curiae*.

Respectfully submitted,

Of Counsel:

JOHN K. ROSENBERG
DAVID P. MUDRICK
THE KANSAS POWER
AND LIGHT COMPANY
818 Kansas Avenue
Topeka, Kansas 66601
(913) 296-8128

BASIL W. KELSEY *
FRANK B. W. MCCOLLUM
CURTIS E. WOODS
MICHAEL F. SAUNDERS
SPENCER FANE BRITT & BROWNE
1400 Commerce Bank Building
1000 Walnut
Kansas City, MO 64106
(816) 474-8100
Attorneys for Amicus Curiae

* Counsel of Record

November 16, 1988

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Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF OF THE KANSAS POWER AND LIGHT COMPANY AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI

STATEMENT OF INTEREST OF AMICUS CURIAE

The Kansas Power and Light Company ("KPL") is a regulated public utility which distributes natural gas to industrial, commercial, and residential customers in the states of Kansas, Missouri, Oklahoma, and Nebraska. KPL is a plaintiff in litigation pending before the United States District Court for the District of Kansas, entitled *In re Wyoming Tight Sands Antitrust Cases*, Nos. 85-2349-S and Consolidated Cases (hereinafter "*Tight Sands*"). Therein KPL asserts claims under

the federal antitrust laws to recover illegal overcharges for natural gas that KPL purchased directly from the named defendants and either resold to its industrial, commercial and residential gas customers, or consumed in the generation of electricity which, in turn, was sold to such customers.

Despite this Court's holdings in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), and *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), each of the defendants in the *Tight Sands* litigation asserted a pass-on defense claiming that KPL "passed-on" any illegal overcharges to its customers. In addition, and subsequent to the filing of KPL's action, the attorneys general of the States of Kansas and Missouri asserted *parens patriae* claims on behalf of indirect purchasers who are residential customers of KPL and other direct gas purchasers. The States' *parens patriae* claims overlap the damage claims brought by KPL.

As a result of the ongoing *Tight Sands* litigation in the District of Kansas, KPL has a vital interest in reaffirmance of the rules set forth in *Illinois Brick* and *Hanover Shoe* barring the use of offensive and defensive pass-on theories, and the strict construction of any exception thereto. The resolution of this case will have a direct and significant impact on the prosecution of the antitrust claims asserted by KPL in the District of Kansas. Affirmance of the Seventh Circuit unique "regulatory equivalent" exception would greatly complicate the discovery process, and could result in all or many of the claims asserted by KPL being dismissed and serious antitrust violations going substantially unremedied.

The validity of the "pass-on" theory and the indirect purchaser claims brought by Kansas and Missouri as *parens patriae* is presently on appeal to the United States Court of Appeals for the Tenth Circuit. *In re Wyoming Tight Sands Antitrust Cases, appeals docketed,*

Nos. 88-8042, 88-8043 (10th Cir. 1988). Oral argument is scheduled for November 18, 1988.

ARGUMENT

I. THE SEVENTH CIRCUIT'S DECISION IN *PANHANDLE EASTERN PIPE LINE COMPANY v. STATE OF ILLINOIS* DIRECTLY CONFLICTS WITH THE REASONING OF THIS COURT IN *ILLINOIS BRICK* AND *HANOVER SHOE*.

In *Panhandle Eastern Pipe Line Company v. State of Illinois*, 852 F.2d 891 (7th Cir. 1988), the Seventh Circuit fashioned a unique "regulatory equivalent" exception to the *Illinois Brick* rule barring indirect purchaser antitrust claims. In so doing, the Seventh Circuit misinterpreted and misapplied the reasoning employed by this Court in *Illinois Brick* and *Hanover Shoe*.

Under the Seventh Circuit's reasoning, indirect residential gas purchasers may prosecute claims under the federal antitrust laws to recover allegedly illegal overcharges "passed on" by regulated public utility companies pursuant to Purchased Gas Adjustment (PGA) clauses contained in the utilities' tariffs. Such claims could be asserted in a variety of ways: by state attorneys general as *parens patriae*, as a class action on behalf of all affected residential consumers, or by separate suits of individual consumers. The Seventh Circuit also would permit industrial gas consumers which purchased gas from the price-fixer through a regulated public utility company to prosecute such claims, unless evidence proves that the regulated public utility absorbed any part of the alleged illegal overcharges by altering its rate structure. Finally, the Seventh Circuit would permit the regulated public utility itself to assert antitrust claims for illegal overcharges only if the utility can demonstrate that it had absorbed a portion of the overcharges in its rate structures. If no such evidence were available or developed, the public utility would be limited to recovering

lost sales profits proximately caused by the illegal overcharges. The Seventh Circuit made no reference to a utility's "commercial" customers (entities ranging from the corner drug store, to the concert hall, to the shopping center) leaving it unclear whether such customers or the utility could sue for overcharges.

Thus, under the Seventh Circuit's approach, both direct and indirect gas purchasers are permitted to assert and prosecute federal antitrust claims. But no one knows who ultimately can recover damages, or the type of damages recoverable, until after lengthy and expensive discovery takes place, demonstrating that the Seventh Circuit's "regulatory equivalent" exception to *Illinois Brick* is wrong for at least three reasons.

First, such an exception necessarily would require a factual analysis of the natural gas industry from wellhead to burner tip, including the structure, operation, and effectiveness of federal and state regulatory controls in the states in which the utility plaintiff does business in order to verify compliance with the policies underlying *Illinois Brick*. This Court, however, specifically prohibited that exercise in *Illinois Brick* because "the process of classifying various market situations according to the amount of pass-on likely to be involved and its susceptibility of proof in a judicial forum would entail the very problems that the *Hanover Shoe* rule was meant to avoid." 431 U.S. at 744-45.

Second, a "regulatory exception" would transform every industrial, commercial, and residential gas customer of the utility in each of the states in which it does business into a potential antitrust plaintiff. Central to this would be the determination of customers' ability to switch to alternative fuels. As noted in *Illinois Brick*, Rule 19(a) and (c), Fed. R. Civ. P., would require joinder or at least identification of all such parties and the possible designation of a class representative. 431 U.S. at 738-39. Largely because of this, the Court prohibited any use

of a pass-on theory which "would transform treble-damage actions into massive multiparty litigations involving many levels of distribution and including large classes of ultimate consumers remote from the defendant." 431 U.S. at 740.

Third, a regulatory exception would require apportionment of damages among numerous industrial, commercial, and residential indirect purchasers located in various states (each with potentially different regulatory schemes) and spread throughout the utility's distribution chain. In KPL's case, for example, the court and jury would be required to allocate damages among numerous gas consumers located in Kansas, Missouri, Oklahoma, and Nebraska. This Court in *Illinois Brick* noted that "such an apportionment would reduce the benefits to each plaintiff by dividing the potential recovery among a much larger group." 431 U.S. at 745. Large scale apportionment of damages, combined with the original uncertainty of recovery, would reduce the incentive to sue, and thereby seriously impair the effectiveness of antitrust actions. Accordingly, this Court held that the important policy of antitrust enforcement "is better served by holding direct purchasers to be injured to the full extent of the overcharge paid by them than by attempting to apportion the overcharge among all that may have absorbed a part of it." 431 U.S. at 746.

The Seventh Circuit's decision plunges antitrust litigation involving regulated public utilities into a nightmare of complexity and confusion, and ultimately will "seriously impair" private plaintiff actions, such as KPL's claims in the *Tight Sands* litigation, as an "important weapon of enforcement." *Illinois Brick*, 431 U.S. at 745. That decision "would substantially erode the *Hanover Shoe* rule without justification." *Illinois Brick*, 431 U.S. at 744.

II. THE EFFECT OF THE SEVENTH CIRCUIT'S DECISION ON THE *TIGHT SANDS* LITIGATION DEMONSTRATES THE UNACCEPTABLE DEGREE OF COMPLEXITY THAT A "REGULATORY EXCEPTION" TO *ILLINOIS BRICK* COULD ADD TO ANTITRUST OVERCHARGE CASES.

Contrary to the Seventh Circuit's depiction of regulated utilities as "reluctant suitors," Pet. App. A-7, KPL filed suit under Sections 1 and 2 of the Sherman Act in September of 1984, *before* the States' *parens patriae* suits were filed, against five natural gas producers (Amoco Production Company, Cities Service Oil and Gas Corporation, CSG Exploration Company, Wamsutter Limited Partnership, and Moxa Limited Partnership, hereafter "producer defendants") and one interstate pipeline (Williams Natural Gas Company, hereafter "Pipeline"). In its complaint, KPL alleges that the producer defendants and Pipeline, acting in combination, unreasonably restrained competition and fixed the wellhead price for Wyoming natural gas sold by the producer defendants to Pipeline.

Pursuant to the parties' combination, Pipeline agreed to buy gas from the producer defendants at artificially high prices and under contracts with anticompetitive terms and conditions that perpetuated the unreasonable prices. Hiding these overcharges within its total purchased gas cost, Pipeline passed-on the artificially inflated prices to numerous downstream purchases, including KPL, and reaped benefits for the combination from those sales. KPL seeks to recover, before trebling, all illegal overcharges paid to the Pipeline for natural gas, as well as all sales profits lost by KPL due to the artificially increased gas prices.

Following the lead of KPL, the attorneys general of the States of Kansas and Missouri subsequently filed virtually identical suits on behalf of State agencies and in their capacity as *parens patriae*. These cases overlap the damage claims of KPL to the extent that the States

claim as damages the illegal overcharges included by KPL in its prices to its indirect residential customers. KPL's action and the States' actions ultimately were consolidated in the *Tight Sands* antitrust litigation now pending in the District of Kansas. The chart, included herein as an Appendix, identifies all of the parties in the *Tight Sands* litigation, their relationship to the challenged conspiratorial conduct, and the relationship of additional unrepresented direct and indirect gas purchasers.

In response to KPL's allegations, each defendant claimed as an affirmative defense that KPL had "passed on" all illegal overcharges to its customers. On motion by KPL, however, the Kansas District Court entered partial summary judgment against defendants on that defense and dismissed *sua sponte* the *parens patriae* claims of Kansas and Missouri. The District Court correctly reasoned that this Court's holding in *Illinois Brick* requires identical treatment of offensive and defensive "pass-on" claims. *In re Wyoming Tight Sands Antitrust Cases*, 1988-2 Trade Cases (CCH) ¶ 68,164 (D. Kan. 1988). The States of Missouri and Kansas (but not the defendants) appealed the District Court's interlocutory ruling to the Tenth Circuit. *In re Wyoming Tight Sands Antitrust Cases, appeal docketed*, Nos. 88-8042, 88-8043 (10th Cir. 1988). The Tenth Circuit is scheduled to hear oral argument of these appeals on November 18, 1988.

One dramatic effect on KPL's case of the Seventh Circuit's decision, if affirmed by this Court or if followed by the Tenth Circuit, will be the exclusion of most or all of the claims asserted by direct gas purchasers who resold gas to indirect gas purchasers. Direct purchasers that appear in the Appendix with broken lines beneath them would lose most or all of their claims. Only end users separately represented in this action—designated in the Appendix by solid lines from the direct purchaser—would remain. But those end users do not and cannot represent all damages incurred at that distribution level.

Indirect industrial and commercial gas purchasers identified in the Appendix have not asserted claims in the action now pending in the District of Kansas. Section 4c of the Clayton Act, which authorizes the *parens* action, expressly restricts state representation to claims of "real persons," thus rendering state representation of the industrial and commercial indirect purchasers under this provision impossible. 15 U.S.C. 15c. Because KPL may not have absorbed a portion of the illegal overcharge and the numerous industrial and commercial gas customers of KPL have not sued separately, every cent of illegal overcharge ultimately allocated to those gas consumers may be rendered unrecoverable if the Seventh Circuit's decision is affirmed. Those overcharges alone constitute more than one half of all damages claimed by KPL.

Ironically, such a result would be 180 degrees contrary to the result the Seventh Circuit struggled to reach. By constructing its *Illinois Brick* exception, the Seventh Circuit advised it was preventing $50 million in illegal overcharges from going "unremedied." Pet. App. A-14. If applied to *Tight Sands*, the Seventh Circuit's approach could result in millions of dollars of overcharges going unremedied.

Additionally, application of the Seventh Circuit's "regulatory equivalent" exception to the *Illinois Brick* rule will substantially increase the complexity of KPL's action, as well as all future antitrust actions involving regulated utilities, to unmanageable levels. Each plaintiff arguably could be required to adduce evidence of its fuel switching capability, each preceding purchase and sale, the degree of elasticity of demand at each level of distribution, and the extent to which an overcharge is absorbed at each level. Indirect buyers will be required to track gas payments upstream from end users, through one or more intermediate purchasers, to direct purchaser and to the conspirators. Establishing this causal chain of injury is complicated, increasing the likelihood of confusion and error at trial, and decreasing the likelihood of

vigorous antitrust enforcement by any potential plaintiff.

These concerns are precisely the same as those faced by this Court in *Hanover Shoe* and *Illinois Brick* which resulted in the rules announced therein.

III. THE PURCHASE GAS ADJUSTMENT CAUSE IN A UTILITY'S TARIFFS IS NOT THE FUNCTIONAL EQUIVALENT OF A FIXED QUANTITY, COST-PLUS CONTRACT UNDER *ILLINOIS BRICK*.

The Seventh Circuit asserts that the PGA clause in a utility's tariffs, combined with state regulation of the utility, constitutes the functional equivalent of the fixed-quantity, cost-plus contract exception under *Illinois Brick*. This assertion is unfounded.

The purchase gas adjustment clause is a provision in the tariffs of regulated utilities in Kansas and elsewhere (including Illinois in the case of Petitioner) which removes, from expenses considered in rate cases, the costs associated with energy purchases by the regulated utility. Beginning in the early 1970's, when energy costs began increasing rapidly, state utility commissions authorized adoption of PGA clauses as a common feature of state utility regulation. The PGA reduced otherwise unmanageable burdens of rate review hearings and rate adjustments required by fuel cost escalations. The PGA also reduced the administrative expense and efficiency losses generated by long delays in the rate review process.

The PGA mechanism, however, does not include a fixed-quantity guarantee for a utility's sales to its customers. To the contrary, the PGA addresses only attempted inclusion of gas costs in the utility's prices, regardless of their effect on subsequent sales; it does not guarantee that a utility, as a direct buyer of an illegally price-fixed product, will not lose sales if an overcharge is "passed

through." The fixed-quantity component of the *Illinois Brick* recognized exception thus is not met.

In the *Tight Sands* litigation, KPL alleges damages that do not overlap those suffered by indirect purchasers. KPL has suffered damages due to load lost when consumers of natural gas either cut back on the amount of gas they purchased from KPL, or switched fuel sources altogether. While the Seventh Circuit would allow KPL to recover damages related to its load loss, it would not permit KPL to sue for damages related to the overcharge. KPL also consumes gas that it does not resell to indirect plaintiffs. The overcharge attributable to this gas is an expense which KPL attempts to recover in its overall rates charged to customers. Depending upon elasticities of demand, KPL's sales correspondingly change.

A PGA clause is not a "magic mechanism" treating purchased gas costs less rigorously than any other utility expense that a regulated entity seeks to recover in its rates. It simply attempts to speed recovery of adjustments in those rates without the expense and delay of a full rate case. It includes and adjusts gas costs in rates; it does not forego review. If attempted inclusion of purchase gas expenses in a utility's PGA constitutes an *Illinois Brick* exception, then one could argue that a utility's recovery of other costs, to the extent they are reflected and can be identified in rates, constitutes an exception as well. *See* 1 A. Priest, *Principles of Public Utility Regulation* 47, 50 (1969). That same argument also could apply to any business' cost which is reflected in its prices, the very thing this Court considered and rejected in *Illinois Brick*.

The Seventh Circuit's decision is therefore flawed and should be reversed.

IV. THE SEVENTH CIRCUIT'S ALLOWANCE OF THESE INDIRECT CLAIMS IS TANTAMOUNT TO PERMITTING STATES, THROUGH THEIR REGULATION OF UTILITIES, TO DEFINE THOSE PARTIES INJURED UNDER SECTION 4 OF THE CLAYTON ACT CONTRARY TO *IN RE CEMENT AND CONCRETE ANTITRUST LITIGATION*, 817 F.2d 1435 (9th Cir. 1987), *prob. jur. noted sub nom., CALIFORNIA v. ARC AMERICA CORP.*, No. 87-1862 (Oct. 3, 1988).

By recognizing a "regulatory equivalent" exception to *Illinois Brick*, the Seventh Circuit endorses a procedure by which a state, either by way of legislation or state agency promulgation of rules or regulations, may determine who may ultimately bring claims for overcharge damages under the federal antitrust laws.

Not only would a state have such authority by creating a PGA or similar mechanism, but it would have the ability to affect a party's standing by how it structures its tariffs and classifies a utility's customers. Moreover, a utility which operates in more than one state could be conferred standing in one state but not in another, depending on each state's practices. Uniform enforcement of the federal antitrust laws by regulated utilities would be impossible.

Such authority on the part of state legislatures and state regulatory bodies is inconsistent with the federal antitrust laws as authoritatively interpreted by this Court in *Illinois Brick*. Permitting the states to "turn on" and "turn off" antitrust standing by the creation of PGA or similar regulatory mechanisms would interfere with the efficient and uniform enforcement of the antitrust laws by private plaintiffs.

This Court has noted probable jurisdiction in a case raising similar policy concerns. *California v. ARC American Corp.*, No. 87-1862, *prob. jur. noted*, —— U.S.

——, 57 U.S.L.W. 3197 (Oct. 3, 1988). This Court should grant the petition here in order to assure uniform interpretation of the federal antitrust laws.

CONCLUSION

The petition for a writ of certiorari should be granted and the judgment of the United States Court of Appeals for the Seventh Circuit should be reversed.

Respectfully submitted,

Of Counsel:

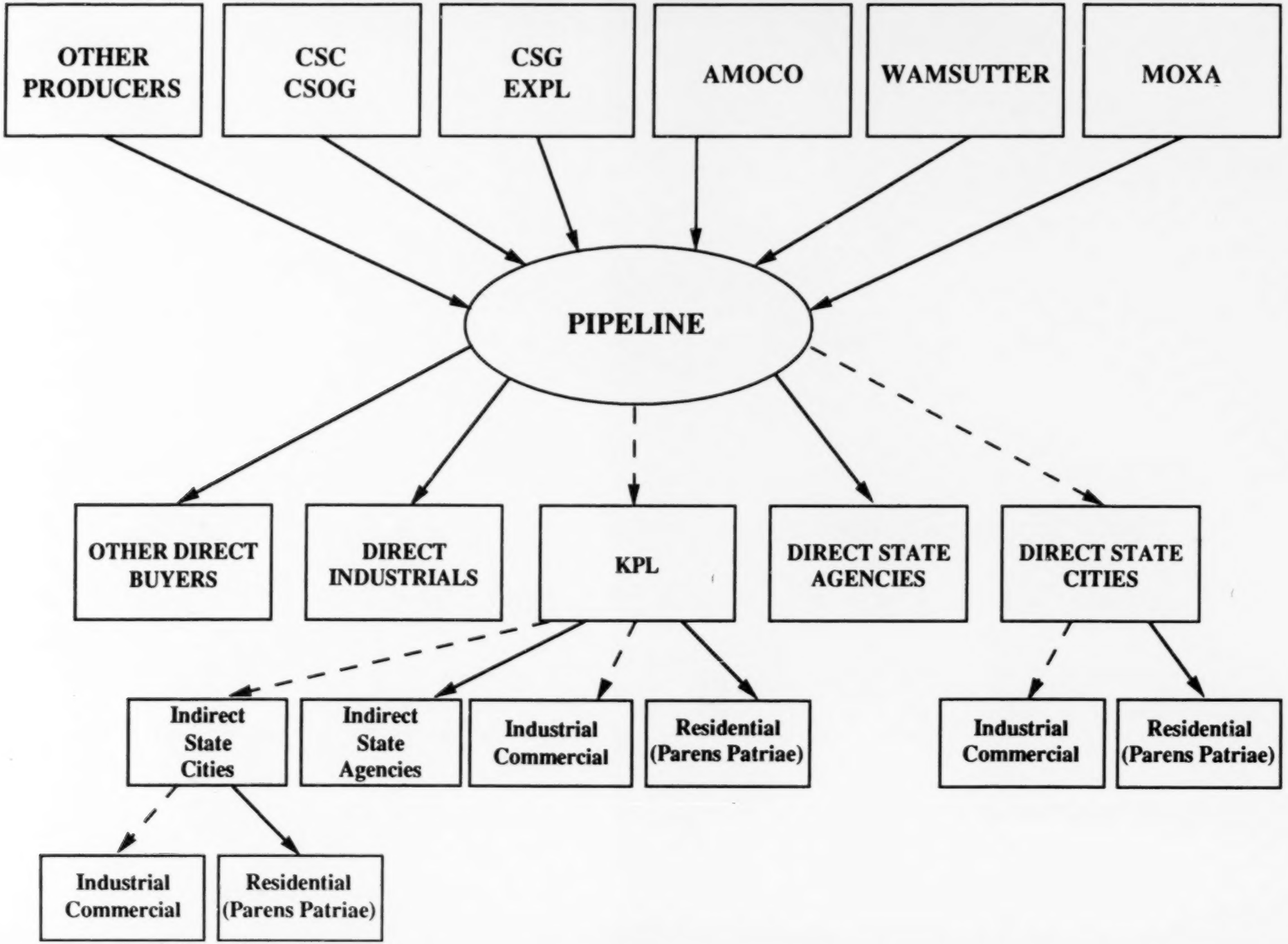
JOHN K. ROSENBERG
DAVID P. MUDRICK
THE KANSAS POWER AND LIGHT COMPANY
818 Kansas Avenue
Topeka, Kansas 66601
(913) 296-8128

BASIL W. KELSEY *
FRANK B. W. MCCOLLUM
CURTIS E. WOODS
MICHAEL F. SAUNDERS
SPENCER FANE BRITT & BROWNE
1400 Commerce Bank Building
1000 Walnut
Kansas City, MO 64106
(816) 474-8100
Attorneys for Amicus Curiae

* Counsel of Record

APPENDIX

Wyoming Tight Sands Antitrust Cases



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NO. 88-658

IN THE
Supreme Court of the United States
OCTOBER TERM, 1988

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,

v.

STATE OF ILLINOIS, *ex rel.* NEIL F. HARTIGAN,
Attorney General of the State of Illinois,
Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

Of Counsel:

JOHN H. CHEATHAM, III
INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA
1660 L Street N. W.
Washington, D.C. 20036
(202) 293-5770

CHARLES W. SCHWARTZ*
DAVID M. BOND
VINSON & ELKINS
3300 First City Tower
1001 Fannin Street
Houston, Texas 77002-6760
(713) 651-2338

Attorneys for Amicus Curiae Interstate Natural Gas Association of America

*Counsel of Record

Alpha Law Brief Co., Inc. — 8748 Westpark—Houston, Texas 77063 — 789-2000

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On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

Pursuant to Rule 42 of the Rules of this Court, the Interstate Natural Gas Association of America ("INGAA") respectfully moves for an order permitting it to file a Brief as *Amicus Curiae*. In support of its motion, INGAA would show:

1. INGAA is a Delaware corporation with its principal place of business in Washington, D.C. INGAA is a non-profit trade association whose membership is comprised of virtually all of the major interstate natural gas transmission companies operating in the lower forty-eight states. INGAA's member companies, one of which is Petitioner, account for approximately ninety percent of all natural gas transported and sold in interstate commerce. INGAA's membership also includes large Canadian interprovincial pipelines which are regulated by the National Energy Board of Canada.

2. Petitioner has raised a question which affects all interstate natural gas pipelines and which therefore affects INGAA. The decision of the court below is incorrect and is adverse to the interests of interstate natural gas pipelines. The Brief that INGAA requests permission to file argues that, because of state regulation, the first purchaser rule of *Illinois Brick Co. v. Illinois,* 431 U.S. 720 (1977), works perfectly when applied to the interstate sale of natural gas to regulated distribution companies. Allowing direct purchasers to recover antitrust damages eliminates the various problems which the Supreme Court's *Illinois Brick* rule was designed to avoid and at the same time the regulatory process will assure that a proper allocation is made of any damage recovery between the direct purchaser and its customers. Thus, there is no need to permit indirect purchaser suits in contravention of *Illinois Brick.*

3. In view of the importance of the question presented in this case, INGAA sought the consent of both Petitioner and Respondent to file its Brief as *Amicus Curiae.* While Petitioner indicated its willingness to consent. Respondent declined to do so. Petitioner's letter of con-

sent is being filed contemporaneously. INGAA files this motion for leave to present its views on this question which it believes may not be fully or adequately presented by the parties. INGAA has an interest in this case that reflects the interest of natural gas pipelines that sell to local distribution companies subject not only to regulation by the State of Illinois but also to similar regulatory jurisdictions in all of the lower forty-eight states, with the exception of Vermont. INGAA's members are also subject to regulation by the Federal Energy Regulatory Commission. INGAA is therefore in an ideal position to present a brief as *Amicus Curiae* dealing with the broad applications of the issue presented. INGAA is also interested in this case because its members are subject to circuit court interpretations of *Illinois Brick* that conflict with the Seventh Circuit's.

For the foregoing reasons, the Interstate Natural Gas Association of America respectfully requests that this Court grant leave to file its Brief as *Amicus Curiae* at or before the time set for the filing of the brief of the Respondent.

Respectfully submitted,

CHARLES W. SCHWARTZ*
DAVID M. BOND
VINSON & ELKINS
3300 First City Tower
1001 Fannin Street
Houston, Texas 77002-6760
(713) 651-2338

*Counsel of Record

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Respondent.

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BRIEF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE

Of Counsel:

JOHN H. CHEATHAM, III
INTERSTATE NATURAL GAS
ASSOCIATION OF AMERICA
1660 L Street N. W.
Washington, D.C. 20036
(202) 293-5770

CHARLES W. SCHWARTZ*
DAVID M. BOND
VINSON & ELKINS
3300 First City Tower
1001 Fannin Street
Houston, Texas 77002-6760
(713) 651-2338

Attorneys for Amicus Curiae Interstate Natural Gas Association of America

*Counsel of Record

QUESTION PRESENTED

Should this Court's holding in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), which bars antitrust suits by indirect purchasers, apply to a *parens patriae* and class action suit brought on behalf of the customers of a regulated public utility when the remedy for an antitrust injury can be more appropriately dealt with in an action brought by the direct purchasing utility?

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On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE

I

INTEREST OF AMICUS CURIAE

INGAA is a nonprofit trade association whose membership is comprised of virtually all of the major interstate natural gas transmission companies operating in the lower

forty-eight states. INGAA's membership also includes large Canadian interprovincial pipelines which are regulated by the National Energy Board of Canada. INGAA's U. S. member companies, one of which is Petitioner, account for approximately ninety percent of all natural gas transported and sold in interstate commerce. INGAA's U. S. member companies, like Petitioner, sell to local distribution companies in all of the lower forty-eight states except Vermont. These local distribution companies are subject to the jurisdiction of their respective public service commissions. The Seventh Circuit misapplied the Supreme Court's decision in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), as it applies to pipelines that sell to local distribution companies regulated by state public service commissions. The Seventh Circuit's ruling, which sanctions antitrust suits by indirect as well as by direct purchasers against interstate pipelines, creates a serious risk of multiple recoveries against the pipelines and complex damage tracing problems in such suits—the two dangers that the *Illinois Brick* court sought to eliminate. INGAA is deeply concerned with the possible adverse consequences of this ruling, especially in view of the fact that its members are subject to conflicting interpretations in other circuits. Its interest here is to help persuade the Court that such adverse consequences can and should be avoided as the Seventh Circuit's ruling is contrary to *Illinois Brick*.

II

SUMMARY OF ARGUMENT

INGAA's argument does not address the merits of the underlying suit against Petitioner nor does it concede that antitrust recovery is warranted in this case. Its argu-

ment instead addresses how the *Illinois Brick* rule ought to apply in this case, assuming for the sake of argument only that an antitrust injury is proved. The direct purchaser rule of *Illinois Brick* works perfectly when applied to the interstate sale of natural gas to regulated distribution comanies. Such companies have a significant incentive under applicable regulatory guidelines to seek to recover antitrust damages for overcharges that have been passed on to their customers. Equally important, the regulatory process will assure that a proper allocation is made of any damage recovery between the direct purchaser and its customers more effectively than will a *parens patriae* or class action. Thus, under the circumstances, there is no need to permit indirect purchaser suits in contravention of *Illinois Brick*.

III

ARGUMENT

Illinois Brick is one of the Supreme Court's most controversial decisions. Since that decision, every Congress has been subjected to numerous attempts to amend or modify the *Illinois Brick* rule. *See* Comment, *The Indirect Purchaser's Right to Sue Under Section 4 of the Clayton Act: Another Congressional Response to Illinois Brick*, 32 Am. U.L. Rev. 1087, 1111-21 (1983). Thus far, Congress has refused to legislate a change in the rule.

The principal political and academic objection to *Illinois Brick* has been that an indirect purchaser may suffer a substantial injury that will not be remedied because only the direct purchaser may recover. This objection has no validity when the direct purchaser is a

regulated utility, however, because in the event of an award, the utility would be required to return any award to its customers. In the instant case, the Seventh Circuit recognized that if Central Illinois Light Company ("CILCO"), the direct purchaser, recovered from Petitioner, it would be required to return the overcharges to its customers, the indirect purchasers. Appendix to Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit ("Appendix") at A-6, 7. But, instead of concluding that this was a better case for the application of *Illinois Brick,* because any consumer injury would not go unremedied, the Seventh Circuit reached the opposite conclusion—that *because* CILCO's customers ultimately would benefit, CILCO would have no incentive to sue. The Court stated:

> The public utility has less to gain from suit than the direct purchaser in the case of the purely private contract. The public utility commission may force the utility to pass on to the consumers any and all damages that the utility recovers, and if it does, utilities will have no incentive to sue because they will have nothing to gain from suit.

Appendix at A-6, 7. In reaching the conclusion, the Court assumed without foundation and incorrectly that CILCO would not have sufficient incentive to pursue overcharges that were passed on to its customers. The Court also apparently failed to consider that a suit by CILCO would be a more desirable alternative for compensating CILCO's customers than would a *parens patriae* or class action suit, the mechanisms through which CILCO's customers would recover in this case.

A. REGULATION BY THE ILLINOIS COMMERCE COMMISSION INSURES THAT CILCO WILL SEEK COMPENSATION FOR ANY OVERCHARGES.

There is no basis for the Seventh Circuit's conclusion that CILCO would not pursue a lawsuit to recover the alleged overcharges. CILCO has sued to recover the very same overcharges that are sought in this case. *See* Appendix at F-1-27. This fact alone belies the Seventh Circuit's conclusion. Equally important, the applicable regulatory framework encourages a utility in the position of CILCO to bring suit. In the case of Illinois, the Illinois Commerce Commission is charged with reviewing utility rate schedules to assure that they are just and reasonable. Ill. Rev. Stat. ch. 111-2/3 ¶ 9-101-252 (1987). A utility's rates must be just and reasonable. *Id.* at ¶ 9-101. In addition, under purchased gas adjustment clauses, such as CILCO has in place, the Illinois Commerce Commission holds annual public hearings to determine whether the utility's gas purchase costs are prudent. *Id.* at ¶ 9-220. The utility has the burden of establishing the prudence of its purchases. *Id.* Because gas purchased at unlawfully inflated prices could not be deemed to be prudently incurred, CILCO would be required to refund any overcharges. *Id.* Thus, CILCO has a very real economic incentive to pursue a lawsuit to recover any overcharges.

It makes little sense to predicate a general rule of standing on speculation that public utilities will not act in accordance with their regulatory obligations. The assumption should instead be that they will act lawfully, and the rule of standing determined accordingly. In this case, CILCO has an incentive to sue and has sued. As

Judge Cudahy, in his concurring opinion, recognized "[u]nder the practical facts of regulation CILCO would ordinarily have a greater incentive to bring this litigation than economic theory suggests." Appendix at A-15. The application of *Illinois Brick* should be guided by these facts.

B. A RECOVERY OBTAINED BY CILCO WOULD COMPENSATE CILCO'S CUSTOMERS MORE EFFECTIVELY THAN A RECOVERY BY THE STATE OF ILLINOIS.

Since it is plain that CILCO has an incentive to sue, the *Illinois Brick* rule should apply to this case unless there is some other compelling reason to except it. None was offered by the Seventh Circuit. In fact, there is a very good reason not to except this case: in the event of a recovery, suit by CILCO would more effectively compensate consumers than would a *parens patriae* or class action suit.

In a *parens patriae* or class action context, difficult problems would be presented with regard to the distribution of the recovery. The relevant statute states:

> Monetary relief recovered in [a parens patriae action] shall—
>
> (1) be distributed in such manner as the district court in its discretion may authorize; or
>
> (2) be deemed a civil penalty by the court and deposited with the State as general revenues;
>
> subject in either case to the requirement that any distribution procedure adopted afford each person a reasonable opportunity to secure his appropriate portion of the net monetary relief.

15 U.S.C. § 15e (1982). Each of the available alternatives is undesirable. If the State attempted to distribute the recovery itself, it would be necessary to implement cumbersome, expensive procedures that would have only limited effectiveness because few consumers would still possess all of their monthly billing statements. If the district court ordered Petitioner to lower its prices to compensate the consumers, there would be undesirable side effects such as windfalls for those who had not been injured. *See* Comment, *Parens Patriae Antitrust Actions for Treble Damages,* 14 Harv. J. on Legis. 328, 355 (1977). In addition, such an order would conflict with FERC regulation. The final possibility, use of a civil penalty, is also undesirable because it would allocate the recovery to the entire population of Illinois, most of which is not served by CILCO or Petitioner. *See id.* at 356.

By contrast, if CILCO recovered damages from Petitioner, distribution of the recovery would be simple and effective. The Commission could allocate the damage award through an administrative proceeding. The Commission could determine the extent to which CILCO's recovery is attributable to its own losses (*e.g.*, because of lower earnings) and the extent to which CILCO's recovery is attributable to costs that were passed on to consumers. With regard to the latter, the Commission could order refunds to the customers who bore the alleged overcharge. CILCO possesses the necessary information and mechanisms to effectuate such an order at a minimal cost. Indeed, such procedures have been used on numerous occasions in cases involving public utilities. *See, e.g., Offshore Construction Costs of Natural Gas Pipelines,* 25 F.E.R.C. ¶ 61,011 (1983) (approving

a settlement agreement under which various interstate pipeline companies flowed through an antitrust recovery to their customers).

In sum, to the extent any recovery is warranted by CILCO, consumers would be more effectively able to recover any overcharges through CILCO than they would through a recovery by the State of Illinois as *parens patriae* or class representative. The Seventh Circuit thus erred not only by assuming that CILCO would not seek a recovery for the consumers, but also by failing to recognize the superiority of an action by CILCO as a means of compensating the consumers.

The Seventh Circuit's decision undermines the fair and uniform application of the antitrust laws and engenders uncertainty for companies subject to suit in many circuits, since the Seventh Circuit permits utility customers and the utility itself to pursue a pipeline while other circuits do not. The risk of disparate treatment is real. Moreover, the decision completely disrupts the pipeline's ability to identify an appropriate party in the dispute for purposes of achieving settlement.

IV

CONCLUSION

For the foregoing reasons, the Interstate Natural Gas Association of America urges this Court to grant the Petition for Writ of Certiorari to review the *en banc* decision of the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

CHARLES W. SCHWARTZ*
DAVID M. BOND
VINSON & ELKINS
3300 First City Tower
1001 Fannin Street
Houston, Texas 77002-6760
(713) 651-2338

Attorneys for Amicus Curiae Interstate Natural Gas Association of America

Of Counsel:

JOHN H. CHEATHAM, III
INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA
1660 L Street N. W.
Washington, D.C. 20036
(202) 293-5770

*Counsel of Record

DATED: November 15, 1988